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Supreme Court, U.
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No. ____

In the Supreme Court of the United States

BP WEST COAST PRODUCTS LLC AND
EXXONMOBIL OIL CORPORATION,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION
AND UNITED STATES OF AMERICA
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

PETITION FOR WRIT OF CERTIORARI

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December 30, 2004

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QUESTIONS PRESENTED

1. Whether the Court of Appeals must follow the precedent set by this Honorable Court?

2. This Court having held that Section 15(7) of the Interstate Commerce Act provided jurisdiction for the Commission to review all rates posted in a newly filed tariff, whether new rates or restated existing rates, can the Court of Appeals decide that Section 15(7) does not apply to restated existing rates?

3. Whether the Commission can abdicate its jurisdiction and duty to ensure that all restated existing rates in a newly filed tariff are "just and reasonable," such statutory jurisdiction having been confirmed by this Honorable Court a half century ago?

4. Whether the Commission and the Court of Appeals can nullify the statutory provision of the Energy Policy Act of 1992 that expressly denies "grandfathered" status to oil pipeline rates that were under investigation within one year of the date of enactment of the Act?

PARTIES TO PROCEEDING

Petitioners are BP West Coast Products LLC and ExxonMobil Oil Corporation.

Respondents are the Federal Energy Regulatory Commission, the federal agency responsible for regulating common carrier oil pipelines pursuant to the Interstate Commerce Act, and the United States of America, a statutory party.

In addition to these parties, the following were parties to the proceedings below:

Chevron Products Company
ConocoPhillips Company
Navajo Refining Company, L.P.
SFPP, L.P.
Texaco Refining and Marketing, Inc.
Ultramar Diamond Shamrock Corporation
Ultramar Inc.
Valero Energy Corporation
Valero Marketing and Supply Company
Western Refining Company, L.P.

RULE 29.6 STATEMENT

BP West Coast Products LLC is a limited liability corporation organized and existing under the laws of Delaware and has its principal office located at 4 Centerpointe Drive, La Palma, California 90623. BP WCP is a refiner and marketer of petroleum products and ships products over the common carrier oil pipeline that is regulated by FERC and subject to the FERC decision on appeal before the U.S. Court of Appeals for the D.C. Circuit. BP WCP is a

subsidiary of BP Products North America Inc., a Delaware corporation, which is a subsidiary of BP America Inc. BP America Inc. is a Delaware corporation with its principal place of business in Warrenville, Illinois. BP America Inc. is a subsidiary of BP p.l.c., the only publicly traded entity in this chain of ownership and whose principal place of business is London, U.K.

ExxonMobil Oil Corporation is a corporation organized and existing under the laws of New York and has its principal office located at 5959 Las Colinas Boulevard, Irving, Texas. ExxonMobil Oil Corporation is a refiner and marketer of petroleum products and ships products over the common carrier oil pipeline that is regulated by FERC and subject to the FERC decision on appeal before the U.S. Court of Appeals for the D.C. Circuit. ExxonMobil Oil Corporation, formerly known as Mobil Oil Corporation, is a wholly owned subsidiary of Mobil Corporation, a Delaware corporation, and which has its principal office located at 5959 Las Colinas Boulevard, Irving, Texas. Mobil Corporation is a wholly owned subsidiary of Exxon Mobil Corporation (formerly known as Exxon Corporation), a New Jersey corporation with its principle office located at 5959 Las Colinas Boulevard, Irving, Texas. The securities of Exxon Mobil Corporation are publicly traded.

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PETITION FOR WRIT OF CERTIORARI

Petitioners BP West Coast Products LLC and ExxonMobil Oil Corporation respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in this case.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the District of Columbia Circuit is published at 374 F.3d 1263 (D.C. Cir. 2004). Petition for rehearing was denied without opinion. Unpublished order issued October 4, 2004.

The decision of the Federal Energy Regulatory Commission, known as Opinion No. 435, is published at 86 FERC (CCH) ¶ 61,022 (1999).

JURISDICTION

The United States Court of Appeals for the District of Columbia Circuit issued its opinion on July 20, 2004, and its orders denying rehearing on October 4, 2004. (App. at 1a, 3a.) The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

RELEVANT STATUTORY PROVISIONS

Section 1(5)(a) of the Interstate Commerce Act ("ICA") provides that "all charges" of common carrier oil pipelines "shall be just and reasonable." 49 U.S.C. App. § 1(5)(a) (1988).

Other relevant provisions of the ICA, including Section 15(7), are reproduced in the appendix to this petition (at 293a).

Relevant provisions of the Energy Policy Act of 1992 are also reproduced in the appendix (at 313a).

STATEMENT OF THE CASE

This petition seeks review of a decision of the United States Court of Appeals for the District of Columbia Circuit upholding a decision of the Federal Energy Regulatory Commission ("FERC" or "Commission") with respect to the scope of jurisdiction of the FERC pursuant to Section 15(7) of the Interstate Commerce Act ("ICA").

(a) Petitioners believe that the decision of the Court of Appeals is inconsistent with a controlling decision of this Court in *Ayrshire Collieries Corporation v. United States*, 335 U.S. 573 (1949).

(b) As a result of ignoring *Ayrshire Collieries,* the Commission is seeking to abdicate its responsibility under the ICA and the Energy Policy Act of 1992 ("EPAct"), the former mandating that the Commission ensure that all rates are "just and reasonable" and the latter expressly reaffirming that mandate.

(c) The Commission and the Court of Appeals have nullified an act of Congress denying "grandfathered" status for rates subject to an investigation within one year of the date of enactment of the act.

The effect of the decision is to achieve a virtual deregulation of common carrier oil pipelines rates that are

carried forward into newly filed tariffs, in violation of the two statutes as well as public policy set by the Congress. If, after more than a half century of jurisdiction of the Commission to review all rates in a newly filed tariff, specifically including restated existing rates, this jurisdiction is terminated, shippers can only challenge existing rates by means of a complaint and thus must assume the burden of proof and, in some cases, forfeit damages. As this case indicates, the time line for a complaint is intolerable. This case has been pending at the Commission for over a decade, and there is no end in sight.[1]

The case arose in 1992 when SFPP, L.P. ("SFPP") filed three new tariffs at the Commission on July 31, 1992. *See* SFPP, L.P. Tariff Nos. 15, 16 & 17 (App. at 252a, 267a, 280a, respectively). Other than adding a new "origin" point on its West Line system and making a rate effective for that point, the tariffs restated the existing rates on all four systems. Passing over protests and complaints that were filed by shippers, we focus here on the critical facts underlying the law in this case: the investigation ordered by the Oil Pipeline Board into all of SFPP's rates, including the refiled rates.

At the time, the Commission had delegated all of its authority under Section 15(7) of the ICA to review new tariff filings to an "Oil Pipeline Board" ("Board" or "OPB"). The Board had the authority to order an investigation into the rates filed, such investigation to be conducted in the form of an on-

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[1] Nor is there any end in sight even for the East Line rates that the Commission found were not "grandfathered" because of an adequate protest/complaint having been filed. The Commission and the Court held that there was no adequate protest/complaint against the West Line rates, a separate system, and we have elected to waive that point in light of the conclusive result of the existence of an investigation.

the-record hearing before an Administrative Law Judge. The Board did not adjudicate anything; the Board's duty was to initiate an investigation into rates in order for a Judge to determine whether or not the rates were "just and reasonable, subject to review by the Commission.

The Board duly ordered an investigation into all of the rates contained in the three new tariffs filed. This investigation encompassed all of the restated existing rates. The public utility thereupon filed amended tariffs recognizing that all of its rates were under investigation, virtually all of the rates being restated existing rates.

Subsequently, the Commission, although never revoking the order of investigation, held that Section 15(7) did not provide jurisdiction to review restated existing rates.

This point was duly raised on appeal, petitioners challenging the proposition that Section 15(7) did not confer jurisdiction on the Commission to review restated existing rates, citing the decision of this Court in *Ayrshire Collieries*, both in brief and on oral argument.

The Court of Appeals upheld the Commission's interpretation of Section 15(7) without any citation to, or other evidence of consideration of, this Court's decision in *Ayrshire Collieries*. As discussed *infra*, in that decision, this Honorable Court expressly held that Section 15(7) did apply to both newly filed rates and restated existing rates. The effect of the Court of Appeals decision is to nullify an act of Congress (EPAct) that specifically denied "grandfathered" status to rates subject to investigation within the one year period prior to the date of enactment of EPAct.

Petitioners are substantially aggrieved, in three distinct ways.

1. The public utility pipeline is allowed to exact unlawful charges from the shippers/consumers and to escape paying damages for past overcharges, in contradiction of the express provisions of EPAct.

First, pursuant to EPAct, rates that were not subject to protest, complaint, or investigation within one year of date of enactment were "grandfathered," and therefore deemed "just and reasonable." A "grandfathered" rate operated, *inter alia*, to cut off damages for unlawful overcharges for two years prior to the date of any subsequent complaint and operated to raise a threshold bar to complaints filed by petitioners in 1994 and 1995.

In sum, if the public utility's rates in this case were subject to an investigation within one year of date of enactment of EPAct, then (a) a subsequent complaint would lie without having to overcome a threshold bar and (b) damages could be awarded going back two years before date of complaint. On the other hand, if the public utility's rates were not subject to an investigation, then (a) a subsequent complaint would face a threshold bar and (b) damages would be limited to commence on the date of the complaint, not two years back.

Petitioners did file complaints in 1994 and 1995. They asserted, *inter alia*, that the public utility's rates were not "grandfathered" because of the investigation timely ordered by the Oil Pipeline Board. Millions of dollars in damages and reparations were sought for the past, and substantially lower "just and reasonable" rates on the utility's West Line were sought for the future. As stated above, the Commission and

the Court rejected this assertion on the ground that Section 15(7) did not apply to refiled rates. This petition follows.

2. With the Commission abdicating responsibility for ensuring that all rates filed for in a new tariff are "just and reasonable," the costly burden of making the public utility's rates lawful falls on the shippers -- often a prohibitive expense. This is a form of de facto *deregulation.*

The second and distinct aggrievement of these and all shippers lies in the fact that in this case of first impression under the EPAct, the Commission has abdicated its statutory authority to examine all rates in newly filed tariffs. That shifts the burden to shippers to assume the Commission's role with respect to restated existing rates, relieves the pipelines of any burden of proof that their restated rates are just and reasonable, and imposes a substantial economic burden on shippers. This result is in spite of the express mandate of the Congress in the EPAct that oil pipeline rates be "just and reasonable" under the ICA, a mandate that the Commission has directly acknowledged.

It would be beyond the pale to suggest that the Congress repealed Section 15(7) of the ICA in whole or in part, or to suggest that the Congress overruled *Ayrshire Collieries*, both *sub silentio*, in the EPAct. No such argument has been raised to date.

The Commission has the jurisdiction, and duty, to ensure that all rates in a newly filed tariff are "just and reasonable," including refiled existing rates that may have become unlawful over time. The Commission must not be allowed to become passive and to shift the cost and responsibility for enforcing lawful rates to shippers.

3. The right of Petitioners to just and reasonable rates under EPAct and the ICA has been abridged by the Commission's and the Court of Appeals' effective nullification of the intent of Congress, as expressed in EPAct, denying "grandfathered" status to rates subject to investigation in the year prior to enactment of EPAct.

Petitioners duly invoked the jurisdiction of the Commission pursuant to Section 13(1) of the ICA. The Commission issued a decision that was duly appealed to the United States Court of Appeals pursuant to Section 17 of the ICA and 28 U.S.C. §§ 2321, 2342, and 2344.

REASONS WHY THE WRIT SHOULD BE GRANTED

This petition for a writ of certiorari should be granted for two principal reasons. First, the Court of Appeals decision flatly conflicts with controlling Supreme Court precedent and operates to negate the mandate of the Congress in the EPAct. Second, FERC's abdication of its continuing power and duty to ensure the just and reasonableness of oil pipeline rates pursuant to the ICA and the EPAct is of national importance and of great significance to shippers and consumers of petroleum products.

I. Conflict With A Decision Of The United States Supreme Court and Nullification of the Express Intent of Congress That Rates Subject To An Investigation Within One Year of Date of Enactment of The EPAct Would Not Be "Grandfathered."

The decision of the Supreme Court of the United States in *Ayrshire Collieries Corporation v. United States*, 335 U.S. 573 (1949), squarely addressed the question of whether the Commission's authority in Section 15(7) of the Interstate

Commerce Act ("ICA")[2] was limited only to new rates filed in a revised tariff and, therefore (it was argued), the Commission had no jurisdiction to review the restated existing rates contained in the new tariff. The Court held that the Commission under Section 15(7) *did* have jurisdiction to review both the new and the restated existing rates filed in a new tariff. *Ayrshire Collieries*, 335 U.S. at 581-583.

The Court of Appeals held the precise contrary, holding that the Commission *did not* have jurisdiction pursuant to Section 15(7) of the ICA to review the restated existing rates filed in a revised tariff. *BP West Coast Products* at 1278. Rehearing on this ground was denied. This petition follows.

In addition to being in conflict with a decision of this Court, the decision nullifies the expressed intent of Congress that rates subject to an investigation within one year of date of enactment would not be granted "grandfathered" status.

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[2] Although the ICA was repealed in 1978, *see* Pub. L. No. 95-473 § 4(b), (c), 92 Stat. 1466, 1470 (Oct. 17, 1978), FERC has "the duties and powers related to the establishment of a rate or charge for the transportation of oil by pipeline or the valuation of that pipeline that were vested on October 1, 1977, in the Interstate Commerce Commission." 49 U.S.C. § 60502 (2003). The relevant version of the ICA was, but is no longer, reprinted in the appendix to title 49 of the United State Code . . . the 1988 edition . . . , the last such edition that reprinted the ICA as it appeared in 1977.

BP West Coast Products at 1271, n.1.

A. The Context Wherein The Conflict of Decisions Was Created.

As noted above, there was, at the time at the Commission, an "Oil Pipeline Board." This Board, specifically recognized in the EPAct, *see* EPAct Section 1804(1) (definition of "Commission" includes the Board), had the delegated authority to initiate "investigations" into new tariff filings pursuant to Section 15(7) of the ICA. ICA § 17(4); *Organization of the Commission; Establishment of Oil Pipeline Board; Delegation of Authority to Oil Pipeline Board*, FERC Stats. & Regs. (CCH) [Regs. Preambles 1977-1981] ¶ 30,007 (1978) (establishing the Board). That is, the independent Board could order that a hearing be initiated before a Presiding Administrative Law Judge, and ultimately the Commission itself, for the purpose of determining whether the rates in the newly filed tariff were "just and reasonable."[3] While ICA Section 15(7) is the vehicle for initiating the investigation, the adjudication is not done by the Board. The adjudication is conducted pursuant to Section 15(1), following the launch of an investigation, with or "without any complaint whatever." Likewise, Section 15(7) gives the Commission, and hence the Board, "authority, either upon complaint or

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[3] Section 375.306(a) of the current [1993] regulations authorizes the Oil Pipeline Board (Board) to exercise the Commission's power under section 15(7) of the ICA to institute investigations of proposed tariff changes. This authority includes suspending a tariff filing on the Board's own motion.

Notice of Proposed Rulemaking, *Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992*, FERC Stats. & Regs. [Proposed Regs. 1988-1998] ¶ 32,497, at 32,734-735, Docket No. RM93-11-000 (March 18, 1993).

upon its own initiative without complaint" to initiate an investigation.

In this case, the Board ordered an investigation into the rates in the entire tariffs. Therefore, *all* of the rates included in the tariffs (whether new or existing) were subject to an investigation, and the Board made the collections of the rates subject to refund. The Board issued a formal order, "Order Accepting For Filing And Suspending Tariffs And Tariff Supplements, Subject To Investigation and Refund, and Establishing Hearing Procedures," *SFPP, L.P.*, 60 FERC (CCH) ¶ 62,252 (1992), and the utility duly complied, filing amended tariffs acknowledging and reflecting the investigation and potential refunds of all of the rates contained in the tariffs. *See* SFPP, L.P. Supplements No. 1 to Tariff Nos. 15, 16 & 17 (filed Oct. 6, 1992) (App. at 264a, 277a, 290a, respectively). All rates were unchanged, restated, existing rates, with the exception of the rate for a new origin to which the utility sought to impose the same rate. Tariffs 16 and 17 only had existing West Line rates. Tariff No. 15 had existing rates for all four of the pipeline's segments.

B. The Conflict of Decisions.

As the Court of Appeals (Judges Sentelle, Rogers, and Roberts in a *per curiam* opinion) put it, some months after date of enactment "the Commission concluded that the OPB lacked authority to open an investigation under Section 15(7) of the ICA, which permits the Board only to investigate newly filed rates or practices." *BP West Coast Products* at 1277 (citation omitted). Therefore, the Commission later concluded that the pending investigation ordered by the Board did not operate to deny grandfathered status to existing rates contained in the newly filed tariff pursuant to EPAct. "Order Denying Rehearing, Clarifying Procedures and Consolidating

Proceedings," *SFPP, L.P.*, 65 FERC ¶ 61,028 (1993); Opinion No. 435, 86 FERC ¶ 61,022 at 61,063 (1999).

The Court of Appeals affirmed:

> But even if common sense bowed to the formalism and the Board's investigation remained technically open, the scope of the Board's investigation – lawful only insofar as it enforces ICA Section 15(7) – must be limited to newly tariffed rates or practices. *See* 49 U.S.C. App.§ 15(7) (1988). As SFPP's tariffs made no changes to the West Line rates (except to add the Watson enhancement and the turbine fuel services), the Board could not have investigated the West Line rates.

BP West Coast Products at 1278.

In absolute contradiction, the Supreme Court in *Ayrshire Collieries* specifically addressed the issue:

> First. It is contended that the Commission in this proceeding had authority to determine the lawfulness only of the proposed rates not of the present rates.
>
> This proceeding is an investigation and suspension proceeding under s 15(7) of the Interstate Commerce Act. That section, which gives the Commission broad authority *upon complaint or its own initiative to investigate* and determine the lawfulness of any new rate, provides that 'after full hearing, whether completed before or after the rate *** goes into effect, the commission may make such order with reference thereto as would be proper in a proceeding initiated after it had become effective.

> The power of the Commission to deal with the situation as if the new rates had become effective is necessarily a comprehensive one. It seems too plain for argument that such broad *authority is ample for the modification of either proposed or existing rates or both*. The power granted the Commission under s 15(1) to deal with rate schedules already effective supports that view. For once the Commission finds the rate to be unjust or unreasonable or unjustly discriminatory or unduly preferential or prejudicial or otherwise unlawful, the Commission is granted the power under s 15(1) to determine and prescribe the just and reasonable rate. The Commission is not bound either to approve or disapprove in toto the new rates that are proposed. *It can modify the proposal in any respect and require that the proposed rates as modified or wholly different rates be substituted for the present ones*. That has been the view of the Commission since the beginning, and we think it is the correct one.

Ayrshire Collieries, 335 U.S. at 581-583 (emphasis added) (footnotes and citations omitted).

This Court thereupon applied the decision to a tariff that only had restated rates in it, as follows:

> The same result obtains as respects the Milwaukee's single-line rates from origins on its lines in the Brazil and Linton groups to Beloit, Wisconsin. The Milwaukee had not proposed any change in those rates. But those rates had been republished in the proposed schedules. They were among the rates suspended by the Commission. And the Commission's order of investigation cited the

> Milwaukee tariff that contains those rates. Hence the Commission sought to bring them into the investigation and gave Milwaukee all the notice to which it was entitled. That the Commission had authority to include them seems clear to us. Even though we assume they are not 'new' rates within the meaning of s 15(7), they are rates 'demanded, charged, or collected' within the meaning of s 15(1).

Id. at 583.

Ayrshire Collieries controls on the point that a Section 15(7) investigation did and does encompass jurisdiction to review existing refiled rates, and, therefore, the Commission, and the Court of Appeals, were in error in holding otherwise. The pipeline's existing rates were properly challenged by the Board's Section 15(7) investigation, thereby vesting the Commission with jurisdiction to determine whether or not all rates, existing or new, are just and reasonable pursuant to Section 1(5) under the procedures of ICA Section 15(1).

It follows that the pipeline rates, existing or new, subject to the Board's investigation order, do not qualify for grandfathered status under EPAct. The decisions of the Commission and the Court of Appeals operate to nullify the express Congressional provision.

While *Ayrshire Collieries* was brought to the attention of the Court, there is no indication that this decision of the Supreme Court was considered by the Court in rendering its decision. A petition for rehearing to the Court of Appeals again calling attention to the controlling authority of *Ayrshire Collieries*, and the omission from consideration, was denied without explanation.

Therefore, this Honorable Court should grant the writ and require the Court of Appeals, and the Commission, to follow this Court's precedent and to give effect to the express Congressional intent to deny "grandfathered" status to rates that were subject to investigation within one year of date of enactment. Petitioners believe that they have the right to the protection of the law, as declared by this Honorable Court, and neither the Court of Appeals nor the Commission can take that right away from them, other than by an Act of Congress.

II. The Commission Should Not Be Allowed To Abdicate Its Statutory Duty To See That Rates on the Oil Pipelines That It Regulates Are "Just And Reasonable."

A. The Issues Are of Exceptional Importance To Shippers and Consumers of Petroleum Products Nationwide.

This is the first case to be adjudicated after the fundamental change in the regulatory regime for oil pipelines under EPAct that established for the first time "grandfathered rates." Thus, this is a case of first impression in the context of a new regulatory scheme overlaying nearly 100 years of regulation of common carrier oil pipelines, the outcome of which will have significant ramifications for FERC's jurisdiction to regulate. One controlling aspect of the law did not change: the Congressional mandate for the Commission to ensure that all rates are "just and reasonable." That ICA mandate was expressly reaffirmed by Congress in 1992 in the EPAct. EPAct § 1801(a).

If, indeed, the Commission is powerless to review the existing rates included in a new tariff filing pursuant to section 15(7) of the ICA, then shippers and consumers of petroleum products, such as motor gasoline and home heating

oil, will be at the mercy of the public utilities' "regulated" monopolies. No more can the Commission be expected to monitor existing rates, however unjust and unreasonable they may have become, as they are refiled, thus no longer protecting the public interest. Instead, the burden is shifted to the consumers to initiate expensive, time consuming, and frustrating complaint litigation that, as this case shows, can go on for more than a decade with no end in sight.

The difference is staggering. If the rates included in a new tariff filing are subject to an investigation, then the burden of proof is on the utility to prove that all the rates are "just and reasonable." If the rates are not just and reasonable, then all shippers are entitled to refunds for overcharges.

To the contrary, in a complaint, the shippers/consumers have to prove first that the rates are not "just and reasonable." All of the necessary books and records are under the control of the utility, as are the derivation of the utility's rates, and it is a challenge for shippers to obtain the numbers even in discovery. Following the shippers' case the pipeline presents its case, typically shifting the "base year" and "test year," which must be rebutted by shippers, so shippers have to fund two cost-of-service studies.

Only the utility is privy to all of the underlying books and records. This Honorable Court recently noted the advantage that a public utility has in this situation. *Verizon Communications Inc. v. FCC*, 535 U.S. 467, 486 (2002). As this Court put it, the prudent-investment rule, designed to address "the natural temptations on the utilities' part to claim a return on outlays producing nothing of value to the public . . . in practice often [was] no match for the capacity

of utilities having all the relevant information to manipulate the rate base . . . ." *Id.*

Then, if the complainants do show that the rates are not "just and reasonable," only the complainant shippers will be entitled to refunds and damages.

Accordingly, this case is of exceptional importance to shippers and consumers of petroleum products nationwide. The Commission should exercise its independent duty to ensure that all rates in newly filed tariffs are "just and reasonable"; the Commission should not be allowed to become passive and to shift the burden on to the shippers/consumers to implement the ICA and the EPAct. The time, expense, and burden of a complaint case virtually eliminate any risk of challenge to unjust and unreasonable rates, except in the most egregious cases, such as the current case.

Further, it was the express intent of the Congress that rates subject to an investigation within one year of date of enactment of the EPAct would not be "grandfathered." By the decisions of the Commission and of the Court of Appeals nullifying this Congressional provision, an additional burden is imposed in the case of this public utility.

The result is *de facto* deregulation in all but the most egregious collection of unlawful rates by public utilities.

B. The Commission Seeks To Abdicate Statutory Responsibility Without The Permission Of The Congress.

As the Commission itself called here for the limiting of its jurisdiction, such a call represents an abdication of

responsibility that should not be tolerated by the Court. As in *Farmers Union Central Exchange v. Federal Energy Regulatory Commission*, when the FERC attempted to abdicate responsibility for ensuring just and reasonable rates on oil pipelines, the Court of Appeals admonished the Commission, pointing out the Commission's duty. "[N]ot even 'a little unlawfulness' is permitted." *Farmers Union Cent. Exch. v. FERC,* 734 F.2d 1486, 1508 (D.C. Cir.) (citation omitted), *cert. denied sub nom. Williams Pipe Line Co. v. Farmers Union Cent. Exch.*, 469 U.S. 1034 (1984) ("*Farmers Union II*"). This Court admonished the Commission on this same principle in *Federal Power Commission v. Texaco*, 417 U.S. 380, 399 (1974) under the Natural Gas Act.

This Court has considered other efforts of administrative agencies to abdicate jurisdiction without Congressional permission. One such case was *Maislin Industries, U.S. v. Primary Steel, Inc.*, 497 U.S. 116 (1990). There, this Honorable Court refused to allow the Interstate Commerce Commission ("ICC") to relinquish jurisdiction, saying that only the Congress could relieve the ICC of its statutory duty. That case is particularly applicable here. Perhaps it is necessary to remind agencies continually that they have the duty to carry out the Congressional mandates, until relieved by the Congress.

The Congress, in enacting the EPAct of 1992, specifically reaffirmed in Section 1801(a) that all rates are to be in accordance with ICA Section 1(5). Under ICA Section 1(5), rates "shall be just and reasonable." 49 U.S.C. App. § 1(5). As the Commission put it, "The Commission concludes that the Act of 1992 [EPAct] does not deregulate oil pipeline rates and that the Commission must continue to ensure that oil pipeline rates are just and reasonable." Order No. 561,

Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992, FERC Stats. & Regs. [Regs. Preambles 1991-1996] ¶ 30,985, at 30,945 (1993), *aff'd, Ass'n of Oil Pipe Lines v. FERC*, 83 F.3d 1424 (1996). Thus, although the Commission acknowledges its duty, it nevertheless has abdicated it.

In fact, in the Commission decision under review, the Commission contradicted itself, stating both that existing rates refiled in a tariff are immune from review and that existing rates refiled in a tariff are subject to review. The precise words for the latter were: "SFPP will have the burden of establishing that any such new or refiled rate is just and reasonable under the ICAct." Opinion No. 435, 86 FERC ¶ 61,022, at 61,117 (1999).

Since the basic public utility model for the filing of new tariffs, including the restatement of existing rates, and the Commission's jurisdiction to address these existing rates, applies to the Commission's jurisdiction over the transportation of natural gas in interstate commerce and jurisdiction over the transmission and wholesale sales of electricity in interstate commerce as well as over transportation of petroleum in interstate commerce, this decision threatens to undermine a fundamental tenet of consumer protection from the predations of the regulated monopolies called "public utilities."

That eviscerates over 100 years of legislation, wherein the Interstate Commerce Commission was created in 1887 and subsequently given expanded jurisdiction, not merely to "call the balls and the strikes" between utilities and the shipper/consumers, but to monitor and assure the public, on its own initiative, that rates are just and reasonable. *Advances in Rates – Western Cases*, 20 I.C.C. 307, 315 (1911) ("the

purpose of Congress in enacting the [Interstate Commerce] act . . . was to establish a body whose function it should be to protect the public interest"). Protests and complaints were an additional adjunct, not the exclusive means of securing Commission oversight. *See* ICA §§ 15(1) & 15(7). Other economic regulatory agencies and statutes followed, mainly in the 1930s, based on the same basic model.

If economic regulatory commissions are now to be rendered purely passive with respect to restated existing rates -- a result doubtlessly to be applauded by the regulated entities, that result should be instituted by the Congress. This kind of passive regulation can be disastrous to the public interest as was recently demonstrated when the FERC sat on its exclusive jurisdiction, doing little or nothing, while the outrageous price spikes in the cost of electricity, the brown outs, the black outs, and the predations of certain jurisdictional marketers ravaged the state of California and the West, with harm reckoned in the billions of dollars.

The result of passivity is that the persons who are supposed to be protected by the Commission would effectively be priced out of the game, except in exceptional circumstances. The consumers, after all, have to pay their own litigation costs and also the litigation costs of the public utility opposing them. *See BP West Coast Products* at 1293-94. The consumers should not be called upon to carry the Commission's water as well.

C. Millions Of Consumers In Arizona, Nevada, And Oregon Will Continue To Be Saddled With The Public Utility's Unjust And Unreasonable Rates Because The Commission Ignored The Law And Granted "Grandfathered" Status To Rates Never Intended To Be "Grandfathered" By The Congress In The EPAct.

The Congress, in the EPAct, expressly denied "grandfathered" status to rates that were subject to an investigation during the year preceding enactment. EPAct Section 1803(a)(2). The law, as determined by this Court long before 1992, was and is, that an investigation reaches both new rates and restated existing rates when a new tariff is filed. There is absolutely no authority for any proposition that the Congress repealed or modified Section 15(7) of the ICA nor this Court's decision in *Ayrshire Collieries*. Therefore, the Congress intended to deny "grandfathered" status to rates such as those involved in this case.

If the investigation pursuant to ICA Section 15(7) is now held to be inapplicable to restated existing rates, then the expressed intent of the Congress to deny grandfathered status to rates subject to an investigation will be frustrated, and millions of consumers in the States of Arizona, Nevada, and Oregon will continue to be saddled with the effects of unjust and unreasonable rates, unless and until some person, outside the Commission, proves that the rates have subsequently been "de-grandfathered." Efforts to do this are in progress, but resolution is years away. *See, e.g.*, "Order on Initial Decision," *ARCO Products Co., et al. v. SFPP,* 106 FERC (CCH) ¶ 61,300 (2004). Recognition that the existing rates included in the tariffs that were subject to the Order of investigation of the Oil Pipeline Board are not "grandfathered" would moot years of present and future

litigation on Energy Policy Act issues, some of this litigation now pending before the Commission[4] and before the Court of Appeals in subsequent appeals,[5] and allow concentration on the question of how to make the public utility's rates "just and reasonable."

In its latest annual report filed with the Commission, SFPP states that its revenues exceed its legitimate costs plus built in profit by $19,543,679, or 19% of its claimed cost of service. 2003 FERC Form 6, Page 700. SFPP's own witness correctly states that this difference represents "excess profit." And that is just the "excess profit" that the public utility admits. "Excess profit," standing alone, translates into "unjust and unreasonable" rates under the ICA, and ultimately the consumer bears these unlawful charges exacted for the transportation service provided by the public utility.

FERC may not "act as an umpire blandly calling balls and strikes for adversaries appearing before it; the right of the public must receive active and affirmative protection at the

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[4] Petitioners or their predecessors filed subsequent complaints in 1997, 1998, 2000, and 2004 alleging that the threshold test for terminating "grandfathered" status has been met in those years, and the issues presented in this petition have, of course, been preserved. In addition, the Court of Appeals did remand the question of whether we met the threshold test for terminating "grandfathered" status for purposes of our 1994 and 1995 complaints. However, even if petitioners are successful in each of these cases, the success will not reach the period for two years prior to date of complaint for reparations and damages. That is solely within this Court's jurisdiction now. Other shippers as well as petitioners have also filed complaints. *See, e.g.*, consolidated cases at Docket Nos. OR96-2, *et al.*, OR04-3, and OR05-4, respectively.

[5] *See* Case No. 04-1102 and consolidated cases.

hands of the Commission." *Scenic Hudson Preservation Conference v. FPC*, 354 F.2d 608, 620 (2d Cir. 1965). The decision below should be reversed so that the Congressional mandate to the Commission to ensure that all rates are just and reasonable will be honored.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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Dated: December 30, 2004

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 99-1020 Consolidated with 99-1051, 00-1221, 00-1240, 00-1256, 01-1413, 01-1453, 01-1469, 01-1475, 02-1008, 02-1011, 02-1321

[Filed October 4, 2004]

BP West Coast Products LLC, Petitioner	)
v.	)
Federal Energy Regulatory Commission and United States of America, Respondents,	)
SFPP, L.P., et al., Intervenors	)

Before: Ginsburg, Chief Judge, and Edwards, Sentelle, Henderson,* Randolph,* Rogers, Garland,* and Roberts, Circuit Judges

* Circuit Judges Henderson, Randolph, and Garland did not participate in this matter.

ORDER

Upon consideration of the petition for rehearing en banc filed by petitioners-intervenors BP West Coast Products, et al., and the absence of a request by any member of the court for a vote, it is

ORDERED that the petition be denied.

Per Curiam

FOR THE COURT:

Mark J. Langer, Clerk

BY:

Michael C. McGrail
Deputy Clerk

APPENDIX B

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 99-1020 Consolidated with 99-1051, 00-1221, 00-1240, 00-1256, 01-1413, 01-1453, 01-1469, 01-1475, 02-1008, 02-1011, 02-1321

[Filed October 4, 2004]

BP West Coast Products LLC,
Petitioner

v.

Federal Energy Regulatory Commission and United States of America,
Respondents,

SFPP, L.P., et al.,
Intervenors

BEFORE: Sentelle, Rogers, and Roberts, Circuit Judges.

ORDER

Upon consideration of petitioners-intervenors SFPP, LP's petition for rehearing filed September 3, 2004, it is

ORDERED that the petition be denied.

Per Curiam

FOR THE COURT:

Mark J. Langer, Clerk

BY:

Michael C. McGrail
Deputy Clerk

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 99-1020 Consolidated with 99-1051, 00-1221, 00-1240, 00-1256, 01-1413, 01-1453, 01-1469, 01-1475, 02-1008, 02-1011, 02-1321

[Filed July 20, 2004]

BP WEST COAST PRODUCTS, LLC, PETITIONER	)
v.	)
FEDERAL ENERGY REGULATORY COMMISSION AND UNITED STATES OF AMERICA, RESPONDENTS,	)
SFPP, L.P., ET AL., INTERVENORS	)

On Appeal from
Petitions for Review of Orders of the
Federal Energy Regulatory Commission

Before: SENTELLE, ROGERS, and ROBERTS, Circuit Judges.

OPINION

Opinion for the Court filed PER CURIAM.

INTRODUCTION

The consolidated petitions before us seek review of four opinions of the Federal Energy Regulatory Commission ("FERC" or "the Commission"):

1. *SFPP, L.P.*, Opinion No. 435, 86 FERC P 61,022 (1999) ("Opinion No. 435");

2. *SFPP, L.P.*, Opinion No. 435-A, 91 FERC P 61,135 (2000) ("Opinion No. 435-A");

3. *SFPP, L.P.*, Opinion No. 435-B, 96 FERC P 61,281 (2000) ("Opinion No. 435-B"); and

4. *SFPP, L.P.*, 97 FERC P 61,138 (2001) ("Clarification and Rehearing Order").

In these opinions FERC considered the tariffs of SFPP, L.P., and complaints and other filings by shipper customers of SFPP. SFPP, L.P., both a petitioner and an intervenor-respondent in the consolidated dockets, operates pipelines that transport petroleum products in Texas, New Mexico, Arizona, California, Nevada, and Oregon. SFPP's operation includes a West Line and an East Line. The West Line consists of pipelines extending from Watson Station in Los Angeles, California, into Arizona to Phoenix and Tucson, and connects at Colton, California, with another pipeline system

extending to Las Vegas. SFPP's East Line consists of pipelines from El Paso, Texas to Tucson and Phoenix. The orders under review consider, set, and otherwise govern rates on both lines. We consider three separate sets of petitions: the petition of SFPP, L.P.; the petition of the West Line Shippers ("WLS"); and the petition of the East Line Shippers ("ELS"). Petitioners and Intervenors include the following: BP West Coast Products LLC ("BP WCP"; formerly ARCO Products Company); Chevron Products Company ("Chevron"; including the former Texaco Refining and Marketing, Inc.); ConocoPhillips Company ("ConocoPhillips"); ExxonMobil Oil Corporation ("ExxonMobil"; formerly Mobil Oil Corporation); Navajo Refining Company, L.P. ("Navajo"); Western Refining Company, L.P. ("Western"); Ultramar Inc. ("Ultramar"); Valero Energy Corporation ("VEC"); Valero Marketing and Supply Company ("Valero"); and SFPP, L.P. ("SFPP").

The administrative proceedings before FERC began with tariff filings by SFPP for both East and West Lines. The lengthy, complex, and convoluted proceedings that followed included complaints and/or protests filed by shippers on the two lines, as well as investigation into SFPP's tariff filings by FERC's Oil Pipeline Board. The issues are further complicated by novelty in that this is the first oil pipeline case in which the "changed circumstances" standard of the Energy Policy Act of 1992 ("EPAct") has arisen for litigation. Energy Policy Act of 1992, Pub. L. No. 102-486, 106 Stat. 2776 (codified as 42 U.S.C. §§ 13201-556 (2003)). While we will not detail the administrative proceedings before FERC's administrative law judge and the full Commission as we discuss them at length in the analyses that follow, we note that issues presented for review include, among other things, the important question of application of the grandfathering principle under the new EPAct, the allocation of litigation

costs between the East and West Lines, tax pass-through problems involving non-taxed subsidiaries of taxable entities, the payment of reparations after a finding of unjust or unreasonable rates, and the correct determination of capital structure to determine a starting rate base. The reader is duly warned.

For reasons set forth more fully below, we are able to affirm many of FERC's answers to specific issues, but because we find error in several fundamental areas, we order the decisions under review vacated and remand the matter for further proceedings consistent with this opinion.

I. The West Line

A. *Grandfathering of Rates under the EPAct*

Section 1803 of the EPAct limits the ability of shippers to challenge pipeline rates in effect at the time of the enactment of the EPAct. Section 1803 provides that any oil pipeline rate that was "in effect" for a full year before the EPAct's enactment on October 24, 1992, and was not subject to "protest, investigation, or complaint" during that 365-day period, is "deemed to be just and reasonable." EPAct § 1803(a)(1). These "grandfathered" rates are categorically immune from challenge in a complaint proceeding under Section 13 of the Interstate Commerce Act ("ICA"), 49 U.S.C. app. § 13(1) (1988) (repealed),[1] except when:

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[1] Although the ICA was repealed in 1978, *see* Pub. L. No. 95-473 § 4(b), (c), 92 Stat. 1466, 1470 (Oct. 17, 1978), FERC has "the duties and powers related to the establishment of a rate or charge for the transportation of oil by pipeline or the valuation of that pipeline that were vested on October 1, 1977, in the Interstate Commerce Commission." 49 U.S.C. § 60502 (2003). The relevant

> (1) evidence is presented to the Commission which establishes that a substantial change has occurred after the date of the enactment of this Act-
>
> > (A) in the economic circumstances of the oil pipeline which were a basis for the rate; or
> > (B) in the nature of the services provided which were a basis for the rate; or
>
> (2) the person filing the complaint was under a contractual prohibition against the filing of a complaint which was in effect on the date of enactment of this Act...

Id. § 1803(b). In the post-EPAct world, the analysis of a pipeline rate challenge thus proceeds in two steps: first, FERC determines whether the rate in question is grandfathered; if it is, FERC then asks whether the rate falls within either of the exceptions outlined in Section 1803(b). The Commission may not alter a grandfathered rate that does not fall within an exception.

B. *Grandfathering of West Line Rates*

The WLS contend that none of the West Line rates are grandfathered, and further argue that even if the rates are grandfathered, their challenges fall within the exceptions set

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version of the ICA was, but is no longer, reprinted in the appendix to title 49 of the United States Code. Therefore, when we refer to FERC's authority under the ICA, we cite to the 1988 edition of the U.S. Code, the last such edition that reprinted the ICA as it appeared in 1977.

out in Section 1803(b). We examine each of these contentions in turn.

1. *Rate "In Effect" for One Year*

To be eligible for grandfathering, a pipeline rate must have been "in effect for the 365-day period ending on the date of the enactment of this Act [October 24, 1992]." EPAct § 1803(a)(1). Thus, to be grandfathered, a rate must have been "in effect" on October 25, 1991, and have remained in effect at least until the enactment of the EPAct.

The WLS do not contest this element with regard to the bulk of the West Line rates. Nor could they; the West Line rates became effective in 1989 pursuant to a settlement terminating a 1985 rate proceeding. *See* Opinion No. 435, 86 FERC at 61,057; *Southern Pac. Pipe Lines, Inc.*, 45 FERC P 61,242 (1988) (order approving settlement). The WLS do, however, challenge the eligibility for grandfathering of certain improvements to the West Line made after October 1991.

a. *East Hynes Origination Point*

In July 1992, SFPP made revisions to its Tariffs Nos. 15, 16, and 17 to add a new origination point on its West Line -- the East Hynes station in Los Angeles County, California -- and to add a rate for shipping services from that new origination point to Arizona. The rate came into effect in October 1992. The rate, however, was not new; it was the same as the rates from SFPP's two other source points in the Los Angeles area. Examining this situation, the Commission concluded that the rates from the East Hynes station qualified for grandfathering because the July 1992 "filing did not involve a change to a rate or service SFPP was providing at the time the EPAct was enacted." Opinion No. 435, 86 FERC

at 61,063. SFPP's revision to its tariffs "only added another tap within an existing rate cluster... No rate ... was changed, and there was no change in the products transported or the services provided." *Id.*

The question essentially boils down to the Commission's interpretation of the term "rate" in Section 1803. As this is the first case to be litigated under the new standards of the EPAct, we must consider the level of deference -- if any -- to which FERC's interpretations of the EPAct are entitled. It is true, as some petitioners have noted, that the EPAct does not expressly confer rulemaking authority on the Commission. Section 1803 of the EPAct does, though, clearly contemplate that the Commission will enforce the terms and conditions of the statute through formal adjudications. *See* EPAct § 1803(b) (referencing "proceeding instituted as a result of a complaint"). When Congress authorizes an agency to adjudicate complaints arising under a statute, the agency's interpretations of that statute announced in the adjudications are generally entitled to *Chevron* deference. *See United States v. Mead Corp.*, 533 U.S. 218, 229, 121 S. Ct. 2164, 150 L. Ed. 2d 292 (2001) ("[A] very good indicator of delegation meriting *Chevron* treatment [is] express congressional authorizations to engage in the process of rulemaking or adjudication that produces regulations or rulings for which deference is claimed."); *see also Trans Union Corp. v. FTC*, 317 U.S. App. D.C. 133, 81 F.3d 228, 230 (D.C. Cir. 1996) ("We have expressly held that *Chevron* deference extends to interpretations reached in adjudications as much as to ones reached in a rulemaking." (citing *Midtec Paper Corp. v. United States*, 273 U.S. App. D.C. 49, 857 F.2d 1487, 1497 (D.C. Cir. 1988))). We see no reason to accord any less deference to FERC's interpretations of the EPAct.

Under the familiar *Chevron* two-part inquiry, we first ask whether Congress has directly spoken to "the precise question at issue." *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842, 104 S. Ct. 2778, 81 L. Ed. 2d 694 (1984). If it has, that is the end of the inquiry; we "must give effect to the unambiguously expressed intent of Congress." *Id.* at 843. If Congress has not spoken so precisely, though, we reach the second step, and will defer to any reasonable interpretation of the statute by the agency. *Id.* Not surprisingly, Congress did not have occasion to confront the specific question of whether the addition of a new source point on an existing rate cluster would constitute a new rate. We thus proceed to the second step of *Chevron*, and inquire whether the Commission's construction is a reasonable one. It is. It is certainly permissible to conclude that the addition of a tap to an existing rate structure, completed without any change in the existing shipping rates, does not constitute a new rate. To employ an analogy that we find helpful, in adding the East Hynes station to its West Line, SFPP merely added an on-ramp to its existing expressway. We think that the Commission's conclusion reflects a permissible interpretation of the statute and thus affirm its holding that the rate for shipping from East Hynes is eligible for grandfathering.

b. *Watson Station Enhancement Facility*

Watson is the primary origin point for West Line shipments to Phoenix and Tucson. In 1989, SFPP notified its shippers that, starting in 1991, the minimum pumping rate and pressure from Watson Station would increase. SFPP gave its shippers the option of providing their own pressurization facilities by a date certain, or using, for a surcharge, a facility built by SFPP. By late 1991, most of SFPP's shippers had contracted to use SFPP's new enhancement facility, and on

November 1, 1991, SFPP initiated the enhancement services. *See* Opinion No. 435, 86 FERC at 61,074; *In re SFPP, L.P.*, 80 FERC P 63,014, 65,156 & n.405 (1997) ("ALJ Decision"). SFPP, though, never filed those contracts with the Commission, because it believed its enhancement services were beyond the reach of FERC's jurisdiction. *See* Opinion No. 435, 86 FERC at 61,074. The Commission, however, concluded otherwise and ordered SFPP "to file a rate equal to the historic charge in the shipper contracts." *Id.* at 61,076.

Despite FERC's concession that "Section 1803 only addresses rates that were on file with the Commission," Opinion No. 435-A, 91 FERC at 61,502, and its acknowledgment that the enhancement rates had never before been filed, FERC nevertheless concluded that, because "the charges for the Watson Station facilities are part of enforceable contracts," the rates were "the equivalent of a lawful, effective rate." Opinion No. 435, 86 FERC at 61,076. The Commission reasoned that because all the Watson enhancement rate contract charges "were in effect before October 24, 1992," the shippers challenging those charges had to establish "substantially changed circumstances." *Id.* at 61,075, 61,076. The fact that no statute permitted a shipper to challenge an unfiled rate before the Commission did not matter. For "if [the rates] had been filed ..., it is clear that they would have been grandfathered because there was no challenge to them during the 12 months proceeding [sic] the enactment of the Act." Opinion No. 435-A, 91 FERC at 61,502.

We find the Commission's reasoning on this point to be fundamentally flawed, and vacate this portion of its order. First, if FERC is indeed correct in its interpretation that Section 1803 applies only to filed rates, the Commission may not grandfather unfiled rates on the assumption that if the

rates had been filed, no challenge would have been brought. The Commission may not regulate rates as if they existed in a world that never was. It must take the rates as it finds them, and here, FERC found them unfiled. If FERC interprets Section 1803 to apply only to filed rates, then it may not extend the benefits of that provision to unfiled rates based on speculation about what would have happened had they in fact been filed. Invoking the so-called "filed rate" doctrine -- which "forbids a regulated entity to charge rates for its services other than those properly filed with the appropriate federal regulatory authority," *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577, 101 S. Ct. 2925, 69 L. Ed. 2d 856 (1981) -- the WLS argue that the pipeline's failure to file a Watson enhancement rate tariff with the Commission precludes the Commission's treatment of the unfiled rate as grandfathered. Our disposition of this issue -- which is based on the Commission's flawed reasoning, and not a flawed conclusion -- does not require us to decide definitively whether Section 1803 of the EPAct applies only to filed rates.

Second, Opinion No. 435 suggests that any rate agreed upon before the EPAct's enactment on October 24, 1992 could be grandfathered. *See* Opinion No. 435, 86 FERC at 61,075 ("The clear purpose of the EPAct's grandfathering provisions is to insulate pipelines from challenges to ... rates ... if those charges were in effect before October 24, 1992."). Section 1803, though, allows grandfathering of only those rates that were in effect (and unchallenged) for at least 365 days prior to the date of enactment of EPAct. EPAct § 1803(a). Even if we assume as a general proposition that Section 1803 applies to unfiled rates, other statements sprinkled throughout Opinion No. 435 suggesting that some of the rates were contracted for after the 365-day window had closed would remain problematic. *See* Opinion No. 435, 86 FERC at 61,075 ("the contracts were entered into voluntarily

by the parties, mostly before the end of 1991"); *id.* ("all the relevant contracts were required to be, and had been, executed well before June 1, 1992"). If the Commission allows Section 1803 to apply to unfiled rates, those rates, to be grandfathered, must be in effect for at least 365 days prior to the EPAct's enactment. The reasoning of Opinion No. 435 gives us no comfort that this was the case. Without such an assurance, we cannot affirm the Commission's conclusion that the Watson enhancement rate is subject to grandfathering.

c. *Turbine Fuel Service*

In December 1992, SFPP filed its Tariff No. 18, proposing the transportation on its West Line of a new product, turbine fuel (also known as jet fuel). The rate for the new turbine fuel service was equal to other grandfathered rates in Tariff No. 18 that had been in effect since 1989. The shippers argue that because the turbine fuel rate was not initiated until 1992 -- long after the grandfathering window had closed (indeed, after the EPAct had been enacted) -- the rate cannot be grandfathered. The Commission does not contest this; it recognized that the turbine fuel service was new, and therefore could not be grandfathered. *Id.* at 61,063. It nevertheless foreclosed further challenge to the turbine fuel rate, concluding, as a *substantive* matter, that the turbine fuel rate was just and reasonable. *Id.* at 61,078. The Commission reasoned that because the turbine fuel rate was equal to other Tariff No. 18 rates that had been deemed just and reasonable, "there is no basis for providing a different rate level for turbine fuel at this time." *Id.*

That analysis falls far short of the mark. The fact that the Tariff No. 18 rates were *deemed* just and reasonable does not mean that the rates actually *are* just and reasonable. Perhaps if the Commission had undertaken a substantive review of the

reasonableness of the West Line rates listed in Tariff No. 18, then its conclusion that the turbine fuel rate is reasonable -- because it is equal to those rates -- might be supportable. But here, the West Line rates had been "deemed just and reasonable" by operation of law -- solely because they had persisted without challenge for one year prior to the enactment of the EPAct. The turbine fuel rate, not itself eligible for grandfathering, cannot simply piggyback on the grandfathered status of other rates. The Commission's contrary conclusion reflects a fundamental misapprehension of the nature and purpose of the grandfathering provisions of the EPAct. The requirements for grandfathering -- the rate must be in effect and not subject to challenge for the year prior to the EPAct's enactment -- are not proxies for actual reasonableness. Those requirements instead operate principally as a means to constrain litigation over pre-EPAct pipeline rates. The fact that the turbine fuel rate is equal to other Tariff No. 18 rates thus says nothing about that turbine fuel rate's substantive reasonableness. The Commission's declaration that, as a *substantive* matter, the turbine fuel rate was just and reasonable -- a conclusion reached without the benefit of any substantive review of the underlying cost of service and rate of return -- was an arbitrary and capricious exercise of the Commission's authority and cannot stand.

2. *Complaints, Protests, or Investigations*

While the WLS concede that most of the West Line rates were in effect for the required year prior to the EPAct's enactment, they contend that no West Line rate is eligible for grandfathering because each of them was "subject to protest, investigation, or complaint" during that same one-year window. In support of their argument, the WLS point principally to protests filed by shippers El Paso Refinery, L.P. ("EPR") and Chevron, and an investigation opened by

the Oil Pipeline Board ("OPB") pursuant to those protests. In October 1993, the Commission rejected these arguments, holding that the West Line rates were "presumed just and reasonable" and, therefore, a successful challenge had to "prove the existence of the extraordinary circumstances set forth in section 1803 of the Energy Policy Act." *SFPP, L.P.*, 65 FERC P 61,028, 61,378 (1993); *see also SFPP, L.P.*, 66 FERC P 61,210 (1994) (denying rehearing).

What does it mean for "the rate" to be "subject to protest, investigation, or complaint"? EPAct § 1803(a). The WLS maintain that a general attack on a tariff is sufficient to challenge all the rates and activities described therein. *See* WLS Br. 14 ("a protest of a tariff filing did subject all rates in the tariff to review"). The Commission, though, in ruling that the shippers' pleadings did not challenge the West Line rates, interpreted this clause of Section 1803 to require that the protest, investigation, or complaint specifically challenge the reasonableness of the rate in question. *See SFPP, L.P.*, 65 FERC at 61,378 n.14 (while Chevron's protest did include "a request for suspension of revised tariff no. 16, which contains ... only west line rates," the protest "pled no concerns with the existing rates set forth in this tariff"). The WLS object to FERC's interpretation on a general level, arguing that it grafts onto the statute a particularity requirement not found in its text. Here, too, we find the *Chevron* deference that we must accord to the agency's interpretation to be dispositive. Because we cannot say that the Commission's adjudicative interpretation is an impermissible reading of the statute -- the statute provides, after all, that it is "the rate" (not the tariff) that must be subject to "protest, investigation, or complaint" -- we defer to the Commission's interpretation. And with that interpretation in mind, we turn to the particular contentions of the WLS.

a. *West Line Shipper Protests*

On September 4, 1992, EPR, an East Line shipper, filed a protest to SFPP's Tariffs Nos. 15 and 16, and followed with three supplements that same month, one of which requested the suspension of Tariffs Nos. 15 and 16 and that the Oil Pipeline Board ("OPB" or "Board") open an investigation into the same. That same month, Chevron, which shipped on both the East and the West Line, filed a protest to Tariffs Nos. 15 and 16, also calling for their suspension and investigation.

The WLS contend that because EPR's and Chevron's protests challenged Tariff No. 16 -- which listed only West Line rates -- those protests had challenged the West Line rates. The Commission rejected this contention, looking beyond the relief requested by the protests to the shippers' substantive arguments for that relief. Examining the relevant pleadings, the Commission concluded that the protesting shippers "raised concerns with only three matters -- flow reversal, prorationing, and existing rates on SFPP's east line." *Id.*, 65 FERC at 61,378. As "nothing within the four corners of these protests indicated a concern with the existing rates on SFPP's west line," the Commission rejected those protests as a basis for denying grandfathered status to the West Line rates. *Id.*

Our examination of the relevant pleadings convinces us that the Commission correctly concluded that EPR and Chevron did not challenge the reasonableness of the West Line rates in their protests to SFPP's Tariffs No. 15 and 16. The EPR and Chevron pleadings scarcely mention the West Line at all, let alone mount an attack on the reasonableness of its rates. The *only* mention of the West Line rates is found in EPR's first supplement to its protest: "Santa Fe's proposed

Tariff Nos. 15 and 16 retain Santa Fe's previously effective rates for service on its East Line and West Line systems, but represent the first tariffs under which product will flow in a reversed direction on the 'Six-Inch Line' portion of the East Line system from Phoenix to Tucson." *In re SFPP, L.P.*, Supplement to Protest of El Paso Refinery, L.P., 1-2 (Sept. 9, 1992) (emphasis omitted). This statement obviously concerns the flow reversal on the Phoenix-Tucson pipe -- not the reasonableness of West Line rates. Chevron's protest, as the Commission noted, "simply fails to contain any statement indicating a challenge to existing rates on SFPP's west line." *SFPP, L.P.*, 65 FERC at 61,378. The Commission thus reasonably concluded that these protests by East Line shippers were insufficient to render the West Line rates "subject to protest." EPAct § 1803(a).[2]

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[2] In August 1993, Chevron filed a complaint that *did* specifically challenge the reasonableness of the West Line rates. *See* ALJ Decision, 80 FERC at 65,121. The WLS maintain that this 1993 complaint should "relate back" to its 1992 protest. We do not agree. Relation back is a concept born in the context of statutes of limitations. Amendments to complaints are said to relate back to the date of the original complaint. *See* Fed. R. Civ. P. 15(c). Even assuming that this suggested use of the relation back doctrine could supersede the Commission's own time limitations governing amendments of protests, the WLS concede that to relate back "the claim ... in the amended pleading [must have] arisen out of the conduct, transaction, or occurrence set forth ... in the original pleading." Fed. R. Civ. P. 15(c)(2). That clearly is not the case here. As the Commission found, Chevron's initial protest "simply fails to contain any statement indicating a challenge to existing rates on SFPP's west line." *SFPP, L.P.*, 65 FERC at 61,378.

b. *Oil Pipeline Board Investigation*

On September 29, 1992, in response to the protests filed by EPR and Chevron, the OPB, pursuant to its authority under Section 15(7) of the ICA, 49 U.S.C. app. § 15(7) (1988), opened an investigation of SFPP's rates listed in revised Tariffs Nos. 15, 16, and 17, suspended the tariffs for one day, and imposed refund obligations on SFPP. *SFPP, L.P.*, 60 FERC P 62,252 (1992).[3] In April 1993, the Commission vacated the suspension orders and the refund obligations. *SFPP, L.P.*, 63 FERC P 61,014 (1993). Observing that the protests against the tariffs did not challenge any change in a listed rate or practice (such as the addition of the East Hynes origination point or the turbine fuel service), but rather attacked only existing, unchanged rates and policies (the East Line rates and the flow reversal and prorationing practices), the Commission concluded that the OPB lacked authority to open an investigation under Section 15(7) of the ICA, which permits the Board only to investigate newly filed rates or practices. *Id.* at 61,125 ("It was not appropriate for the Board to suspend the proposed tariff changes and initiate an investigation under section 15(7) when the focus of the protest was existing, unchanged, portions of the tariff."); 49 U.S.C. app. § 15(7) (1988) (limiting application to "any schedule stating any *new* individual or joint rate ... or charge") (emphasis added). The Commission held that the case should continue as a complaint proceeding before the Commission under ICA Section 13(1), *id.* § 13(1), and be

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[3] After SFPP filed Tariff No. 18, adding the turbine fuel service on the West Line, the OPB, acting pursuant to a protest by Chevron to Tariff No. 18, instituted an investigation and consolidated that case into the open investigation and suspension of SFPP's Tariffs Nos. 15, 16, and 17. *SFPP, L.P.*, 62 FERC P 62,060 (1993).

limited to the issues properly raised by EPR, Chevron, and the intervenors. *SFPP, L.P.*, 63 FERC at 61,125. But as the Board "does not possess delegated authority to order initiation of a section 13(1) proceeding," the Commission vacated the tariff suspensions and the refund obligations. *Id.* The Commission eventually terminated the Board's suspension docket entirely, stating that matters would proceed only in the instant complaint docket. *SFPP, L.P.*, 63 FERC P 61,275 (1993). And based on its conclusion that the OPB's investigation had been unlawfully initiated, the Commission determined that SFPP's West Line rates were not "subject to investigation" for grandfathering purposes. *SFPP, L.P.*, 66 FERC at 61,480.

Parsing with care the words of the Commission's countermand of the Board, the WLS argue that the Commission never formally vacated the Board's investigation of the SFPP's Tariffs Nos. 15-18, and thus the rates within those tariffs -- including the West Line rates -- remained subject to investigation in 1992, precluding grandfathered status. We, like the Commission, are unpersuaded. First, while the WLS are quite right that the Commission did not, in its ordering clauses, vacate the Board's investigation, the shippers' interpretation of the Commission's action runs head-on into the Commission's statement that it was inappropriate "to suspend the proposed tariff changes and *initiate an investigation* under section 15(7)." *SFPP, L.P.*, 63 FERC at 61,125 (emphasis added). Moreover, the shippers offer no explanation how such an investigation by the Board could proceed in light of the Commission's order that the case would continue as a Section 13(1) complaint. But even if common sense bowed to formalism and the Board's investigation remained technically open, the scope of the Board's investigation -- lawful only insofar as it enforces ICA Section 15(7) -- must be limited to newly tariffed rates or

practices. *See* 49 U.S.C. app. § 15(7) (1988). As SFPP's tariffs made no changes to the West Line rates (except to add the Watson enhancement and the turbine fuel services), the Board could not have investigated the West Line rates.

We therefore conclude that FERC reasonably determined that the West Line rates (except, as noted above, for the Watson Station enhancement and turbine fuel rates) were grandfathered and therefore deemed just and reasonable under the terms of Section 1803(a) of the EPAct.

C. *Exceptions to Grandfathering*

We turn now to the WLS' contention that the rates fall within the exceptions outlined in Section 1803(b) and therefore are still open to challenge under the ICA. Section 1803(b) permits a shipper to challenge a grandfathered rate if the shipper establishes either that (1) there has been a "substantial change" in the economic circumstances or services provided that "were a basis for the rate"; or (2) "the person filing the complaint" was under "a contractual prohibition against the filing of a complaint" on the date of the enactment of the EPAct. EPAct § 1803(b). The complaining shipper bears the burden of proving the existence of one of the circumstances triggering an exception. The Commission concluded that the WLS had not met either requirement. *See SFPP, L.P.*, 68 FERC P 61,105, 61,581 (1994) (contractual prohibition); Opinion No. 435, 86 FERC at 61,064-71 (changed circumstances). The shippers were therefore barred by the EPAct from challenging the grandfathered West Line rates. The WLS appeal both rulings.

1. *Substantially Changed Circumstances*

Before the ALJ and the Commission, the WLS argued that there were five circumstances that had substantially changed so as to permit a challenge to the grandfathered West Line rates, including increased throughput on the West Line and the impact of the Commission's *Lakehead* decisions on SFPP's income tax cost allocation. The ALJ rejected all the substantial change arguments. *See* ALJ Decision, 80 FERC at 65,192-96. Concerning the claim based on throughput, the ALJ concluded that the evidence of a forty-percent increase in throughput from EPAct's enactment in October 1992 to 1995 (the last year for which data was obtained), by itself, could not prove a change in economic circumstances. *Id.* at 65,194. Missing, according to the ALJ, was any evidence demonstrating that the increase in throughput produced higher revenues and profits for SFPP. *Id.*

The Commission affirmed the holdings of the ALJ on each of the WLS' claims of substantial change, *see* Opinion No. 435, 86 FERC at 61,064-71, but, with respect to the throughput claim, did so on somewhat different reasoning, *see id.* at 61,067-69. The Commission found that the ALJ had erred by measuring change from the date of enactment of the EPAct, and by using data generated after the filing of the shippers' complaint. *Id.* Determining whether there has been a substantial change in economic circumstances providing the basis for the rate, the Commission held, requires comparing (a) the period before the rate first became effective (the basis for the rate) with (b) the period starting on the date of enactment and ending on the date of the complaint. *Id.* The WLS' substantial change claim based on increased throughput failed because the shippers measured changed circumstances against the "wrong base period" and with post-complaint evidence. *Id.* at 61,069. To establish a substantial change,

FERC held, the shippers should have compared the period before the West Line rates became effective in 1989 to the period between October 24, 1992 (EPAct's enactment) and August 7, 1993 (the date of Chevron's complaint).

The shippers contest neither the Commission's interpretation of the substantial change provision of EPAct, nor its conclusion that the shippers failed to demonstrate a substantial change under that standard. The WLS do, however, maintain that the Commission's ruling employed a "newly articulated standard" and that they are, therefore, entitled to a remand so that they may have an opportunity to litigate under the Commission's "new" evidentiary requirements. WLS Br. 23. We reject this contention.

Even before the Commission announced this interpretation, the correct points of comparison in a substantial change analysis were clear from the face of the statute. The statute requires a shipper to show a change in economic circumstances "which were a basis for the rate." EPAct § 1803(b). As the Commission noted in its Opinion No. 435, this phrase could only mean "the basis upon which the rate was last considered to be just and reasonable, either as a filed rate, a settlement rate, or one for which the Commission has made a legal determination." Opinion No. 435, 86 FERC at 61,068. Any other moment in time would lack "correlation to the economic circumstances that were the basis of the rate at the time it was designed." *Id.*

The textual clues to the second point of comparison are perhaps less obvious but no less certain. The statute provides that "no person may file a complaint ... unless ... evidence is presented ... which establishes that a substantial change has occurred after the date of ... enactment." EPAct § 1803(b). From the "after the date of enactment" language we are given

the earliest point at which a shipper may show a substantial change. The closing date for evidence is the day the complaint is filed; this conclusion follows from the language providing that no "complaint" may be filed unless "evidence is presented" with the complaint that demonstrates that a substantial change "has occurred." As the Commission stated, "it is difficult to see how language that so explicitly uses the past tense could apply to evidence that would be developed at some indeterminate time after the complaint is filed." Opinion No. 435, 86 FERC at 61,069. Because the foregoing requirements of the statute are clear from its face, the shippers had adequate notice of the standard they were required to meet. *See, e.g., Midtec Paper Corp.*, 273 U.S. App. D.C. 49, 857 F.2d 1487, 1510 (D.C. Cir. 1988) (rejecting petitioner's argument that it had inadequate notice specific evidence was required to support its complaint where the text of the regulations at issue "clearly indicates" that such evidence was to be considered).[4]

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[4] *Consolidated Edison Co. v. FERC*, 354 U.S. App. D.C. 235, 315 F.3d 316 (D.C. Cir. 2003) and the other cases cited by the shippers (*see* WLS Br. 23) are distinguishable. Those cases stand for the unremarkable proposition that when an agency abandons its own precedent in the course of an adjudication, the new rule may be applied retroactively to the parties only "so long as the parties ... are given notice and an opportunity to offer evidence bearing on the new standard." 315 F.3d at 323 (citing *Hatch v. FERC*, 654 F.2d 825, 835 (D.C. Cir. 1981)). Here, FERC did not abandon its own precedent. Shippers point to *Santee Distrib. Co. v. Dixie Pipeline Co.*, 71 FERC P 61,205 (1995), *reh'g denied*, 75 FERC P 61,254 (1996), but that ruling -- issued nearly two years after Chevron's complaint was filed, and several months after the parties had submitted their direct cases to the ALJ, *see* ALJ Decision, 80 FERC at 65,121 -- stands solely for the proposition that, to make out a substantial change under EPAct Section 1803, the complainant

The WLS also argue that the Commission erred in rejecting their argument that the Commission's decision in *Lakehead Pipe Line Co., L.P.*, 71 FERC P 61,338 (1995) (*Lakehead*), *reh'g denied*, 75 FERC P 61,181 (1996) ("*Lakehead II*"), insofar as it changed the ability of limited partnerships like SFPP to include certain income tax allowances in their cost of service, represented a substantial change in SFPP's economic circumstances. The Commission reasoned that the mere existence of the *Lakehead* policy, without any showing how the application of that policy affects the economic basis for the rates, cannot constitute substantially changed circumstances. *See* Opinion No. 435, 86 FERC 61,070-71. In light of our conclusion below that aspects of the Commission's *Lakehead* policy are arbitrary and capricious, we think the best course is to remand this claim to the Commission for further consideration in light of our disposition in this case.

2. *Contractual Prohibition*

The WLS next contend that they may challenge the grandfathered West Line rates because they fit within the "contractual prohibition" exception. That exception allows a shipper to challenge a grandfathered rate when "the person filing the complaint was under a contractual prohibition against the filing of a complaint which was in effect on the date of enactment of [the EPAct] and had been in effect prior to January 1, 1991." EPAct § 1803(b)(2). Navajo, as a part

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must show some change in circumstances since the enactment of the EPAct. *See Santee Distrib. Co.*, 71 FERC at 61,754 ("Comparisons of data for 1987 to data for 1993 cannot be the basis for showing a change in economic circumstances since enactment of the EPAct."). That holding is entirely consistent with the holding of Opinion No. 435.

of an earlier settlement with SFPP, was subject to such a prohibition and thus was permitted to file a complaint against the West Line rates without demonstrating substantially changed circumstances. *See SFPP, L.P.*, 67 FERC P 61,089, 61,254 (1994). Navajo, however, reached another settlement with SFPP and withdrew its complaint against the pipeline. *SFPP, L.P.*, 79 FERC P 63,014 (1997). The Commission then terminated the Navajo complaint proceeding. *SFPP, L.P.*, 80 FERC P 61,088 (1997).

The WLS nevertheless argue that they, too, should not have to show substantially changed circumstances. First, they assert that Navajo's invocation of the contractual prohibition exception effectively vitiated the West Line rates' grandfathered status as to *all* complaining shippers. *See* WLS Br. 18 ("The 'grandfathered' status of the West Line rates ... was thus revoked."). Alternatively, the WLS argue that because the ALJ conditioned Navajo's "withdrawal of the complaint" on "not prejudicing in any way the status and rights of any other participants in this proceeding," *SFPP, L.P.*, 79 FERC at 65,176, the other complaining shippers should be able to pursue their complaint as if Navajo had not withdrawn -- that is, without showing substantially changed circumstances. The Commission rejected both of these arguments. From the first, the Commission recognized that the contractual prohibition exception is party-specific. "Because neither Chevron nor ARCO/Texaco was subject to a contractual bar [as was Navajo], it follows, under the plain meaning of the language of the statutory provision, that the complaints of Chevron and ARCO/Texaco [must show substantially changed circumstances]." *SFPP, L.P.*, 68 FERC at 61,581. As for the shippers' claim that they had been prejudiced by Navajo's withdrawal, the Commission concluded that the condition on Navajo's settlement applied

only to "the integrity of the record." Opinion No. 435, 86 FERC at 61,073.

We agree with the Commission. The language of Section 1803(b)(2) is quite obviously party-specific. EPAct § 1803(b)(2) ("*the person filing the complaint* was under a contractual prohibition") (emphasis added). An interpretation, like that suggested by the WLS, that would allow other shippers to piggyback on the status of a contractually-prohibited shipper, conflicts not only with the plain language of the statute, but also with Section 1803's overarching purpose of limiting litigation over pre-EPAct rates. On the other hand, the Commission's interpretation -- limiting the exception to those parties actually contractually prohibited from complaining -- is entirely consistent with the statute and therefore reasonable. We also find no merit to the WLS' claim that they were somehow prejudiced by Navajo's settlement. After examining the relevant proceedings, *see SFPP, L.P.*, 79 FERC at 65,176, we think it clear that the ALJ, in implicitly promising that Navajo's withdrawal would not "prejudice ... the status and rights of any other participants in proceeding," was referring only to the evidence that Navajo had placed into the administrative record.

II. The East Line

SFPP's East Line rates were not grandfathered under § 1803 of the EPAct, as EPR, as an ELS, had challenged them in the same September 1992 complaint in which it had protested SFPP's flow-reversal on the six-inch line. They were therefore "subject to protest, investigation, or complaint" within the year prior to the EPAct's enactment. Navajo later filed its own complaint against the East Line rates, and the Commission proceeded under the ICA, which,

in Section 15, empowers the Commission to set aside rates it finds "unjust or unreasonable," and to "determine and prescribe what will be the just and reasonable ... rates, fares or charges to be thereafter observed." 49 U.S.C. app. § 15(1) (1988). The ALJ evaluated SFPP's East Line rates pursuant to its cost of service regulations, 18 C.F.R. § 346.2 (2004), found them unjust and unreasonable, and proceeded to set new ones in their place. ALJ Decision, 80 FERC at 65,122-191. The Commission substantially affirmed the ALJ's determination in Opinion No. 435. 86 FERC at 61,084-111. Under the Commission's rate-of-return methodology, this involved determinations of SFPP's embedded capital costs, its yearly operating expenses, allowances for other costs, and its appropriate rate of return. *See* 18 C.F.R. § 346.2(c).

The proceedings before the Commission were complex, and many of the issues it decided in setting new East Line rates (and in determining that the previous rates were unjust or unreasonable) have not been challenged. As relevant to our review, the parties dispute only four discrete issues regarding the Commission's East Line rate-setting: (1) the starting rate base to which SFPP was entitled; (2) what tax allowance, if any, should be factored into rates; (3) the proper means of recovery, if any, of SFPP's litigation expenses; and (4) the treatment of SFPP's claimed expenses for reconditioning portions of the East Line.

The court reviews the Commission's ratemaking decision to determine whether it was arbitrary and capricious, *see Association of Oil Pipelines v. FERC*, 317 U.S. App. D.C. 376, 83 F.3d 1424, 1431 (D.C. Cir. 1996) ("*AOPL*"), according special deference to the Commission's expertise, *id.* at 1431; *see also In re Permian Basin Area Rate Cases*, 390 U.S. 747, 790, 88 S. Ct. 1344, 20 L. Ed. 2d 312 (1968). The court thus examines the Commission's ratemaking

decisions to determine whether the Commission has examined the relevant data and articulated a rational connection between the facts found and the choice made. *AOPL*, 83 F.3d at 1431. The Commission must "cogently explain why it has exercised its discretion in [the] given manner." *Exxon Corp. v. FERC*, 340 U.S. App. D.C. 374, 206 F.3d 47, 54 (D.C. Cir. 2000) (quoting *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 48-49, 77 L. Ed. 2d 443 (1983)).

A. *Starting Rate Base*

The Commission decided that to measure SFPP's overall investment upon which it is entitled to a return, SFPP should use its December 19, 1988 capital structure. Opinion No. 435-A, 86 FERC at 61,503-06. In assessing the value of a pipeline's invested capital, the Commission's approach -- stemming from its opinion in *Williams Pipeline Co.*, 31 FERC P 61,377 (1985) ("Opinion No. 154-B") -- weighs equity and debt-financed capital investments made prior to 1985 differently, and SFPP contends that the Commission used the wrong historical ratio between the two in setting the starting rate base.

Some explanation of the "starting rate base" concept and its history is necessary. Prior to June 28, 1985, the rate base to be included in oil pipeline cost of service analysis was calculated under an Interstate Commerce Commission ("ICC") valuation method, which combined elements of original and reproduction cost. In *Farmers Union Central Exchange, Inc. v. FERC*, 189 U.S. App. D.C. 250, 584 F.2d 408, 417-20 (D.C. Cir. 1978) ("*Farmers I*"), the court expressed concerns about the ICC's valuation methodology, particularly its tendency to overvalue assets so as to "exceed[] investment by a substantial amount." *Id.* at 415. After the

Commission proposed to continue to use the ICC's valuation method in *Williams Pipeline Co.*, 21 FERC P 61,260 (1982), the court, on review from that decision, remanded the case in *Farmers Union Central Exchange, Inc. v. FERC*, 236 U.S. App. D.C. 203, 734 F.2d 1486, 1510-14 (D.C. Cir. 1984) ("*Farmers II*"), and directed the Commission to consider alternatives, noting the widespread agreement among many experts that the ICC's method "lacks any economic rationale." *Id.* at 1511 (internal citation omitted).

On remand from *Farmers II*, the Commission developed its current "trended original cost" method. Opinion No. 154-B, 31 FERC at 61,833-35. This method starts from the original cost of a pipeline's assets but smooths out depreciation and equity recovery over the life of the pipeline, thereby avoiding the front-loading problems associated with a depreciated original cost methodology. Making the switch to this "trended original cost" method required the Commission to account for investments in existence at the time of the change. Under the ICC's valuation rate base methodology, many of these had been valued substantially above investment cost. *See Farmers I*, 584 F.2d at 415. Setting their value to depreciated original cost would, in many cases, have significantly decreased their valuation for rate-setting purposes. *See* Opinion No. 154-B, 31 FERC at 61,836. To mitigate any abrupt reduction in pipeline earnings resulting from the change, the Commission permitted a one-time rate base adjustment -- creating a so-called starting rate base -- calculated by partially continuing the ICC's valuation method to the extent of a pipeline's equity ratio, but assessing its rate base at depreciated original cost to the extent of its debt ratio. Opinion No. 154-B, 31 FERC at 61,835-37. Because the stated purpose of this approach was to protect the expectations of investors who had invested prior to the switch, the Commission determined that the relevant debt-to-equity

ratio would be a pipeline's capital structure as of the date of Opinion 154-B, June 28, 1985, rather than its capital structure at the time rates are set. *See Williams Pipeline Co.*, 33 FERC P 61,327, 61,640 (1985) ("Opinion No. 154-C").

The court has never reviewed the reasonableness of the Commission's Opinion No. 154-B methodology, nor need we do so now, as no party has challenged whether that approach is faithful to the court's remand order in *Farmers II*, 734 F.2d at 1511-21. The ELS support the Commission's application of the Opinion No. 154-B methodology, and SFPP contends only that the Commission's use of December 19, 1988 rather than June 28, 1985 as the relevant snapshot of the pipeline's capital structure is not faithful to Opinion No. 154-B and its progeny. We turn, then, to SFPP's contention that the Commission acted arbitrarily and capriciously, and departed from past precedent without adequate explanation, in rejecting use of the actual June 28, 1985 capital structure of the Santa Fe Southern Pacific corporation ("SFSP"), the pipeline's then-parent.

SFPP did not yet exist in 1985, and its predecessor corporation, Southern Pacific Pipelines, Inc. ("SPPL"), was a wholly-owned corporate subsidiary of SFSP. SPPL therefore had a 100% equity structure, and no party urged the Commission to use that capital structure to calculate SFPP's starting rate base. SPPL's parent, SFSP, was capitalized at 78.29% equity and 21.71% debt at the time, and SFPP urged the Commission to follow Opinion No. 154-B's instruction to use the parent's capital structure to calculate the starting rate base. Initially, in Opinion No. 435, 86 FERC at 61,089-90, the Commission took the position that the 1988 settlement agreement between SPPL and several of its shippers, which had last set the pipeline's rates, required the use of SFSP's capital structure in the starting rate base. On rehearing in

Opinion No. 435-A, however, the Commission decided that the settlement did not preclude it from independently examining SFPP's capital structure after the rates set by the settlement expired. The Commission determined that SFSP's capital structure should not be used in the starting rate base calculation because SFSP's high equity component in June 28, 1985 did not "accurately reflect[] the risks of SFPP's underlying operations," and there was a "significant difference in the nature of the pipeline's operations and those of its parent company on June 28, 1985." Opinion No. 435-A, 91 FERC at 61,504-05.

SFPP contends that Opinion No. 154-B requires, in cases where a pipeline is owned by a parent company and therefore does not issue debt in its own name, the use of a parent company's capital structure as of June 28, 1985. Opinion No. 154-C, which clarified Opinion No. 154-B, does contain the instruction that "the capital structure to be used in determining the starting rate base is as of the date of Opinion No. 154-B (June 28, 1985)." 33 FERC at 61,640. The Commission qualified that approach, however, in *ARCO Pipeline Co.*, 52 FERC P 61,055, 61,233-34 (1990), where it began applying its precedents from the rate-of-return context -- in which it first examines whether a parent company's capital structure is representative of its subsidiary's risk level before imputing it to the subsidiary -- to the capital structure used in the starting rate base calculation. While the Commission in *ARCO* ended up using the corporate parent's actual capital structure, it indicated that its decision to do so hinged on "whether the capital structure is representative of the pipeline's risks." *Id.* at 61,233.

ARCO did not contain much by way of explanation about why the representativeness of a parent's capital structure to the pipeline's risks should matter; its relevance to the starting

rate base, where the equity component is standing in as a measure of investor reliance on the old ICC valuation method, appears less obvious than in the rate-of-return context, where pipelines receive different returns on debt and equity to compensate for their different risk levels, *see*, *e.g.*, *Kuparuk Transportation Co.*, 55 FERC P 61,122, 61,375-78 (1991); *Alabama-Tennessee Natural Gas Co.*, 25 FERC P 61,151, 61,417-18 (1983). But the Commission's basic premise that a capital structure representative of a pipeline's risks must be used in the starting rate base calculation is not at issue, for SFPP concedes that the Commission can depart from a parent's actual capital structure if it is "not ... representative of the pipeline's risks." SFPP Pet. Br. 17. SFPP's challenge goes only to whether the Commission made a reasoned decision applying that standard, and nothing about the Commission's determination of SFPP's, SPPL's, and SFSP's relative risk levels was arbitrary or capricious.

The Commission noted that the bulk of SFSP's business was in the railroad, trucking, and mineral exploration industries, which faced substantially higher amounts of competition than the pipeline, a regulated "monopoly for the entire period" guaranteed a fair rate of return and "sufficiently secure that it proposed to undertake a major expansion beginning in 1985." Opinion No. 435-B, 96 FERC at 62,067. Most importantly, the Commission had a powerful piece of evidence of the pipeline's relatively low risk level: its initial public offering. When it first became a stand-alone entity on December 19, 1988, SFPP was able to adopt a capital structure financed with 60.74% debt and 39.26% equity. This strongly suggests a market judgment that the pipeline was significantly less risky than SFSP, which was financed with 78.29% equity and 21.71% debt. The Commission's view that SFPP's equity level as of its initial public offering more "accurately reflected the pipeline's risk"

than that of its previous parent was based upon a reasoned view that "the financial market's perceptions of the pipeline's risk," as demonstrated through an "arms length public offering," provide an accurate estimate of an entity's risk level. 96 FERC at 62,068. SFPP misses the mark when it states that there is no single capital structure dictated by the market, for although other reasonable debt-equity ratios might have been adopted for SFPP, none would have market imprimatur. The reasonableness of the Commission's position is confirmed by the very different nature of the respective entities' business operations and the stark contrast between the capital structures each adopted. The same reasoning explains the Commission's choice to use December 19, 1988, the date of SFPP's initial public offering, as the relevant snapshot of its equity level, hardly an arbitrary date given its reliance on the judgment of the financial markets.

SFPP maintains, however, that by adopting SFPP's December 19, 1988 capital structure for purposes of the starting rate base calculation, the Commission improperly applied it "retroactively," thereby denying the pipeline a fair chance to bring itself in line with the capital structure hypothesized. The Commission's use of the December 19, 1988 capital structure was predicated on the conclusion that it was representative of the pipeline's risks in 1988, and that there were "no rational grounds here to believe that SPPL's operations or business substantially changed between June 28, 1985 and December 19, 1988." Opinion No. 435-B, 96 FERC at 62,067. SFPP points to nothing that suggests otherwise. The starting rate base is an element of the determination of the prospective rates "in dispute in this proceeding," and the Commission was neither altering past rates nor seeking to recover the pipeline's past losses in future rates; rather, it was determining a just and reasonable valuation of the pipeline's investment for the purpose of

setting present rates. As such, there was nothing "retroactive" about the Commission's setting of the starting rate base.

Because the record contained sufficient evidence on which the Commission could find that SPPL faced significantly lower risks than SFSP in 1985, and SFPP concedes that the Commission may depart from an actual capital structure in the starting rate base formula where it is not representative of a pipeline's risks, the court has no occasion to decide whether the Commission improperly relied on non-record material from Moody's Transportation Manual regarding the poor financial condition of the Southern Pacific Railroad during the relevant period. Nor need we decide whether the Commission's other basis for departing from SFSP's 1985 capital structure--its concern that SFSP's 78.29% equity component would yield an exorbitantly high starting rate base--would suffice to uphold its decision. Accordingly, we affirm the Commission's starting rate base decision.

B. *Cost Issues*

1. *Income Tax Allowance*

As one element of the cost of service allowable to SFPP, FERC included a 42.7% income tax allowance reflecting the interest in the regulated entity held by a subchapter C corporation. All petitioners assigned this tax allowance as error. The shipper petitioners, and intervenors supporting them, allege as error the recognition of any income tax allowance as SFPP is a limited partnership that pays no income taxes. SFPP alleges as error the denial of a full income tax allowance. Because FERC has not established that its 42.7% allowance is the product of reasoned decisionmaking and indeed has provided no rational basis for

this part of its order, we find that allowance to have been erroneous and we vacate.

There is no question that as a general proposition a pipeline that pays income taxes is entitled to recover the costs of the taxes paid from its ratepayers. We explained this proposition thoroughly in *City of Charlottesville v. FERC*, 249 U.S. App. D.C. 236, 774 F.2d 1205 (D.C. Cir. 1985) (Scalia, J.). While we will not fully discuss the analysis set forth in that decision, we will briefly review the basic principles as background for the current controversy.

The Commission must ensure that the rates of jurisdictional pipelines are "just and reasonable." *Id.* at 1207 (quoting 15 U.S.C. § 717c(a) (1982)). This means that using the principles of cost of service ratemaking, Commission-approved rates must yield "sufficient revenue to cover all proper costs," and provide an appropriate return on capital. *Id.* (citing *Pub. Serv. Co. of New Mexico v. FERC*, 653 F.2d 681, 683 (D.C. Cir. 1981)). Taxes, including federal income taxes, are costs. *See id.* at 1207. The difficulty in the application of this seemingly straightforward principle arises when "the utility is part of a consolidated group," only a portion of which is regulated. *Id.* Historically, the Commission has employed two differing methodologies for attribution of tax costs in dealing with this difficulty. Again, *City of Charlottesville* provides the background for understanding the two methodologies. Under the older, "flow-through" methodology, the Commission "derived an effective tax rate by determining the ratio of each [regulated] pipeline's taxable income to the total taxable income of all affiliates, multiplied this fraction by the group's consolidated tax liability, and divided this figure by the pipeline's taxable income." *Id.* at 1207. Under the more recently derived "stand-alone" methodology, the Commission has sought to

segregate the regulated utility, then determine "the taxable income and deductions ... specifically attributable to the utility's jurisdictional activities." *Id.* Under this approach, the Commission then applies "the statutory tax rate ... to the tax base to yield the stand-alone tax allowance." *Id.* The present controversy arises from the fact that neither of these historic methods can by its terms be literally applied to the rates of SFPP.

The name of the jurisdictional pipeline operator explains the origin of the difficulty. SFPP, L.P., is a limited partnership -- specifically a publicly-traded one. Both the flow-through and stand-alone methodologies presume taxable income generated by the regulated entity. Each arose in the context of corporate ownership of a jurisdictional pipeline by a tax-paying corporation which is part of an affiliated group. Shipper petitioners concede that were SFPP a subchapter C corporation, a tax allowance would be appropriate in order "to insure that the regulated entity has the opportunity to earn its allowed return on equity." *Lakehead,* 71 FERC at 62,314. But a limited partnership operating jurisdictional pipelines incurs no income tax liability. 26 U.S.C. § 7704 (d)(1)(E). Therefore, shipper petitioners contend there is no rational basis for FERC to approve an income tax allowance for a limited partnership that incurs no income taxes. Thus, shippers argue, FERC erred in allowing even a 42.7% tax allowance in the rates of SFPP.

Shippers raised this argument before the Commission and the Commission discussed it in Opinion No. 435. *See* 86 FERC at 61,101-07; *see also* Opinion No. 435-A, 91 FERC at 61,508-09; Opinion No. 435-B, 96 FERC at 62,077-78. In all of its iterations, FERC's discussion of the issue has been in terms of the "*Lakehead* policy." FERC first announced that policy in *Lakehead*, 71 FERC P 61,338, and offered certain

clarifications of the policy in *Lakehead II*, 75 FERC P 61,181. That case also involved ratemaking of a limited partnership. In *Lakehead*, the Commission declared that where a regulated pipeline is a non-taxed limited partnership, it will not be permitted the same tax allowance as it would if the pipeline company were a corporation. However, FERC further ruled that where the limited partnership includes corporate partners, it would treat the partnership as being "in essence a division of each of its corporate partners" for purposes of determining an income tax component in the partnership's cost of service computation. *Lakehead*, 71 FERC at 62,315. Importantly, FERC's opinion in *Lakehead* was never subjected to judicial review, and neither this court nor any other circuit has ever passed on the validity of the *Lakehead* policy. Therefore, while FERC may deem itself bound to follow that policy, we are not so bound and consider its validity for the first time in this application. All petitioners urge us to reject it in whole or in part, though for differing reasons.

Commencing with the assumption that it should apply the *Lakehead* policy to SFPP's ratemaking, FERC considered the question before it to be the determination of how that policy applied to a limited partnership composed of one partner (or partners) that is a subchapter C (taxpaying) corporation and other partners that are not subchapter C corporations but rather individuals, subchapter S corporations, trusts, or other entities that do not incur corporate income tax. FERC's analysis is rooted in the rationale offered in *Lakehead*, discussed in the ALJ Decision, *see* 80 FERC at 65,179, and adopted by the Commission in Opinion No. 435, *see* 86 FERC at 61,102. The Commission bases that rationale on the "double taxation" incurred in the context of subchapter C corporations, in which the profitmaking corporation is liable for corporate income tax and the shareholders of the

corporation are individually liable for their individual income tax on dividends generated by the profitmaking corporations.[5] The Commission in *Lakehead* ruled that "because the corporate tax is an extra layer of taxation, the Commission includes an element for the corporate taxes in the cost-of-service to insure that the regulated entity has the opportunity to earn its allowed return on equity." 71 FERC at 62,314. This same rationale guided the Commission's computation of tax allowance for the nontaxpaying limited partnership, including one or more subchapter C partners, throughout the *Lakehead* administrative litigation and the SFPP ratemaking now before us. Because SFPP, Inc., a subchapter C corporation, held a 42.7% interest[6] in the SFPP limited partnership, the Commission included in the cost of service computation for SFPP, L.P., a 42.7% allowance for income taxes that would have been incurred had the pipeline's jurisdictional earnings been subject to corporate taxation. 86 FERC at 61,103.

Shippers contend that FERC erred in including this income tax allowance, arguing that the ALJ was correct that because no income taxes have been or will be paid on SFPP's partnership income, the inclusion of an income tax allowance in the cost of service constitutes allowance for "phantom taxes." *Id.* SFPP, on the other hand, contends that the 42.7% allowance is in fact inadequate to reflect cost of service. It

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[5] In our discussion of the double-taxation rationale, we are advertent to actual and proposed changes in corporate and dividend taxation occurring after the ratemaking we now review. In view of the timing of the ratemaking, and of our resolution of this issue, no such changes are germane to our further analysis.

[6] A 41.7% limited partnership interest and a 1% general partnership interest.

argues that the *Lakehead* policy results in an understatement of the appropriate income tax allowance, and that the Commission should have applied a version of the "stand-alone" methodology discussed above, treating the regulated entity as if it alone were responsible for taxes which would have been incurred on the same income had the jurisdictional pipeline been a taxable corporation.

Because we conclude that FERC's rationale does not support its conclusion, we hold that inclusion of the 42.7% income tax allowance in the cost of service computation was erroneous and we vacate FERC's order to that effect. We further conclude that SFPP's arguments are not well-taken and reject the proposition that FERC should have included the 100% allowance that SFPP seeks. We further conclude that the shipper petitioners offer a convincing analysis consistent with ratemaking principles and governing law, and that on the record before us SFPP is entitled to no allowance for the phantom income taxes it did not pay.

We cannot conclude that FERC's inclusion of the income tax allowance in SFPP's rates is the product of reasoned decisionmaking. In *Lakehead*, as re-adopted in the opinion before us, the "reasoning" consists of a recitation of separately unassailable statements that do not together constitute a syllogism leading to the conclusion purportedly based on them. The Commission in *Lakehead* reasoned that:

> 1. Under cost-of-service ratemaking principles a regulated company is entitled to rates that yield sufficient revenue to cover its appropriate costs.
>
> 2. Income tax allowance is no different from the allowance for any other costs.

> 3. When the regulated entity is organized as a corporation, its revenues are taxed at the corporate tax rate and the earnings of the owners (shareholders) of the corporation are then taxed on dividends at their particular rate.

71 FERC at 62,314.

To that point the Commission's statements are unassailable. However, the Commission follows these statements with a rather cryptic statement. "Because the corporate tax is an extra layer of taxation, the Commission includes an element for the corporate taxes in the cost-of-service to ensure that the regulated entity has the opportunity to earn its allowed return on equity. However, there is no allowance for the taxes paid by the owners of the corporation." *Id.* Again, the second of these two sentences is inarguable, but it is not at all clear what the Commission means by the first. It would seem to follow from the Commission's own reasoning in the preceding elements of analysis, as well as fundamental principles of ratemaking, that if the corporate tax is to be included in the cost-of-service, it is not because it is "an extra layer of taxation," but rather because it is a *cost*. *Id.* In the Commission's own words, a tax allowance is "no different from the allowance for any other costs." *Id.* Presumably whatever tax rate was applicable to a tax-paying regulated entity would be included in the cost-of-service analysis, nor does anything said by the Commission in *Lakehead* or in the opinions before us dispute that presumption. From this line of "reasoning," FERC proceeded to conclude that the limited partnership operating a jurisdictional pipeline "is entitled to an income tax allowance with respect to income attributable to its corporate partners." *Id.* The only further explanation that FERC offers for this conclusion is "when partnership interests are held by

corporations, the partnership is entitled to a tax allowance in its cost-of-service for those corporate interests because the tax costs will be passed on to the corporate owners who must pay corporate income taxes on their allocated share of income directly on their tax returns." *Id.*

The Commission then goes on to "conclude[] that [the limited partnership pipeline] should not receive an income tax allowance with respect to income attributable to the limited partnership interests held by individuals ... because those individuals do not pay a corporate income tax." *Id.* at 62,315. Presumably, however, the individual owners pay individual income taxes. Also, presumably many owners (shareholders) of corporate holders of limited partnership interests will not be paying taxes on dividends as corporations often do not generate dividends.[7] In the original *Lakehead* opinion, the Commission had little further to say about why it distinguished between the corporate taxes of corporate unit holders and the individual income taxes of individual unit holders. In *Lakehead II*, and in the opinions we review today, the Commission did offer some attempt to explain the distinction.

In *Lakehead II*, FERC considered the argument of the *Lakehead* limited partnership that the Commission's refusal to grant a tax allowance reflecting the tax liabilities of all limited partnership unit holders, whether or not each holder was a subchapter C corporation, did not comport with the Commission's own "actual taxes paid" rationale, because the

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[7] As noted in n.5, *supra*, changes in tax laws subsequent to the Commission's opinion herein may further affect the asymmetry of including in ratemaking allowance for the corporate tax of corporate unit holders but not the individual tax of individual unit holders.

Commission, under the "stand-alone" tax policy discussed above, would permit "a regulated entity to collect a fair tax allowance even where no actual tax liability is incurred." *Lakehead II*, 75 FERC at 61,594. *Lakehead II* went on to argue that under this rationale, even if the jurisdictional entity is a non-taxed limited partnership, "rate payers should be responsible for the tax liability otherwise associated with the revenue generated from the jurisdictional activities, without regard to any actual amount paid to the IRS." *Id.* In rejecting the argument, the Commission stated, no doubt correctly, that in the case of a jurisdictional corporate subsidiary of a corporate group, "the allowed equity return generates an actual tax liability for the pipeline that must be paid to the IRS, either in cash or through the use of another member's deductions... Either way, the tax liability of the jurisdictional company is a real cost of providing service." *Id.* at 61,595 (citing *Northern Border Pipeline Co.*, 67 FERC P 61,194, 61,110-11 (1994)). As applied to tax liability generating corporate subsidiaries engaged in jurisdictional activities, the Commission's statement is again quite defensible, when such a subsidiary does not itself incur a tax liability but generates one that might appear on a consolidated return of the corporate group. The difficulty arose when the Commission attempted to take the next step and explain why this reasoning applied to an entity that is a non-taxable limited partnership and to justify discriminating between allowances for the tax liability of corporate unit holders and the tax liability of those unit holders who are individuals or otherwise not subchapter C corporations. The Commission's reasoning on that point extends for two more paragraphs, but is summarized in the following statement immediately following the last quoted language from *Lakehead II*:

> In contrast, there is no corporate tax liability associated with individual partners' equity return and

> therefore it is not appropriate to allow Lakehead to collect for such amounts in its cost-of-service.

Id. This does not supply reasoning for differentiating between individual and corporate tax liability. It is merely restating the proposition that the Commission is so differentiating. Otherwise stated, the Commission is once again simply declaring: we are including a tax allowance for corporate tax liability; we are not allowing a deduction for individual income tax liability. To re-phrase a proposition is not the same as supplying supporting reasoning. In short, the Commission's opinions in *Lakehead* do not evidence reasoned decisionmaking for their inclusion in cost of service of corporate tax allowances for corporate unit holders, but denial of individual tax allowances reflecting the liability of individual unit holders.

Nonetheless, we could sustain the Commission's decision if the opinions we review had added the reasoned decisionmaking lacking in *Lakehead*. They do not. Before the court, the Commission's counsel argues that the distinction is justified in the reasoning offered by the ALJ in the portion of his decision affirmed by the Commission. The ALJ, attempting to apply the *Lakehead* policy, had reasoned that "investors in a regulated pipeline are entitled to a return 'commensurate with returns on investments in other enterprises having corresponding risk.'" ALJ Decision, 80 FERC at 65,177 (quoting *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603, 64 S. Ct. 281, 88 L. Ed. 333 (1944)). Still struggling with the *Lakehead* policy which had permitted a corporate income tax allowance but not an allowance for the tax liability of other investors in the limited partnership, the ALJ concluded "because there is no dual taxation, a tax allowance is not necessary to ensure that an individual limited partner obtains a 'commensurate return.'" *Id.* We agree that

the ALJ's invocation of the *Hope Natural Gas Co.* principle was apt, but unlike the Commission, we agree that the conclusion he based it on was sound.

The *Hope Natural Gas* decision did not itself involve attribution of tax liability for purposes of determining allowances and ratemaking. It did however, apply general principles of ratemaking that are instructive in that context. As the Commission argues to us, that decision teaches that the Commission's ratemaking function involves "a pragmatic assessment of whether the rates prescribed for a pipeline will support its services and provide a reasonable return to its investors." FERC Br. 60 (citing *Hope Natural Gas*, 320 U.S. at 602; *Farmers II,* 734 F.2d at 1502). However, the Commission's premise again does not lead to the Commission's conclusion. The ALJ correctly derived from *Hope Natural Gas* the more specific principle that the regulating commission is to set rates in such a fashion that the regulated entity yields returns for its investors commensurate with returns expected from an enterprise of like risks. Were the corporate unit holders investing in a non-regulated entity of like risk and otherwise similar return, they would of course expect to pay their own corporate tax on any profit they might realize from that investment. Should that profit generate dividends from the corporations, the shareholders would expect to pay their own taxes on such dividends.[8] Likewise, individual investors in such a non-regulated enterprise would expect to pay their individual taxes thereon. Granted, the second group of investors would pay one level of taxation; the first group, at least potentially, two layers of taxation. This is a product of the corporate form, not of the regulated or unregulated nature of the pipeline or any comparable

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[8] *See* footnotes 5 and 7, *supra*.

investment or of the risks involved therein. Therefore, consistent with *Hope Natural Gas*, the ALJ correctly concluded that where there is no tax generated by the regulated entity, either standing alone or as part of a consolidated corporate group, the regulator cannot create a phantom tax in order to create an allowance to pass through to the rate payer. The Commission erred when it rejected the ALJ's conclusion.

As we have recited repeatedly above, and as the Commission itself has recognized in this very proceeding, under cost-of-service principles, a regulated company is entitled to a rate design to yield sufficient revenue to cover its appropriate cost; income tax allowance is no different from the allowance of any other costs. The regulated pipeline generates many costs, for example bookkeeping expenses. Presumably those bookkeeping expenses are recoverable in its rates. Its corporate unit holders, if any, presumably also have bookkeeping expenses. The bookkeeping expenses of the corporate unit holders are not recoverable in the rates of the pipeline, even though the corporation and its shareholders each may independently be paying bookkeepers and accountants unlike individual unit holders who pay only for their own accounting. All of this makes sense. It makes equal sense when applied to income taxes.

SFPP, while raising its own objections to the *Lakehead* policy, joins the Commission in opposing the shipper petitioners' arguments that no income tax allowance should be included in the ratemaking. SFPP, however, argues that the Commission not only did not err in including the potential tax liability of its corporate unit holders, it instead erred in not including the potential tax liability of its individual or other non-subchapter C corporate unit holders. That argument serves to illustrate further why the ALJ was correct in

including no such pass-through or phantom taxes at all. Under the Commission's present order, the imputed tax liability of the corporate unit holders creates an allowance included in the making of the rate for the pipeline. The ratepayers pay that rate for the product shipped, but the allocation of the nontaxed profit of the limited partnership pipeline is, so far as the record reflects, subject to division among the unit holders rateably according to their interest in the limited partnership, not affected by how their share of the profits will ultimately be taxed. Therefore, even if the Commission's goal of changing the risk analysis of "double-taxed" investors were a valid one, it is not being accomplished. The inclusion of the phantom taxes in the rate changes the profit margin for all unit holders in the untaxed limited partnership, not just those who are under a particular tax structure. Therefore, SFPP may well be correct that if such an allowance were allowable at all, it should have been allowed for the imputed taxes potentially incurred by all unit holders who realized taxable income from the untaxed profits of the limited partnership of the pipeline. For the reasons set forth above, we hold that the first step of this analysis is erroneous -- that is, we hold that no such allowance should be included.

Both FERC and SFPP argue that the position we adopt today is inconsistent with the "stand-alone" methodology approved by this court in *City of Charlottesville*, for reasons related to the so-called "actual tax" principle discussed therein. *City of Charlottesville*, 774 F.2d at 1207, 1215. Again, we will not rehash the full analysis of *City of Charlottesville*, but simply will remind SFPP that the stand-alone principle as approved in *City of Charlottesville* dealt with the imputation of taxes within a corporate structure where the imputation was made necessary not by the non-taxable, non-corporate nature of the regulated entity, but by the allocation of profits and losses among the related members

maintaining separate balance sheets within a consolidated corporate group. While it is true that then-Judge Scalia posited the applicability of the stand-alone methodology to a circumstance in which taxes were "not necessarily ... paid," *id.* at 1215, that analysis dealt with the use of "actual or estimated taxes paid or incurred" rather than being limited to actual taxes paid. But the part of the *City of Charlottesville* opinion in which that discussion occurred dealt with the argument that the taxes, though properly estimated and actually incurred, might not ever be actually paid because of such factors as losses generated in the corporate structure, or the allocation of profits between and among taxable years in such a fashion as to result in a different tax actually being paid, if any at all. *See id.* at 1214-15. Nothing in the *City of Charlottesville* opinion suggests that it is the business of the Commission to create tax liability when neither an actual nor estimated tax is ever going to be paid or incurred on the income of the utility in the ratemaking proceeding.[9]

Finally, SFPP argues that adopting the *Lakehead* policy and applying it to this case to restrict the allowance to the taxes of the corporate unit holders as opposed to imputing the taxes of all unit holders "runs directly contrary to legislation in which Congress expressly sought to encourage the publicly

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[9] At least equally inapposite is *Carolina Power and Light v. FERC*, 274 U.S. App. D.C. 5, 860 F.2d 1097 (D.C. Cir. 1988). SFPP relies on *Carolina Power and Light* for the proposition that "the Commission is not obligated in prospective ratemaking proceedings to match rates dollar for dollar with taxes paid to the Internal Revenue Service." *Id.* at 1101 (internal quotations omitted). There, again, we dealt with the computation of the precise amount of taxes to be passed through, not whether the Commission could create a tax liability out of whole cloth to pass through to rate payers of a nontaxable utility.

traded partnership formed for oil pipelines and other selected industries." Underlying this argument is Congress's 1987 enactment of Section 7704 of the Internal Revenue Code. 26 U.S.C. § 7704 (added by Pub L. 100-203, Title X, § 10211(a), Dec. 22, 1987, 101 Stat. 1330-403). Under Section 7704, Congress decreed that, in general, publicly traded limited partnerships would be taxed as corporations. However, Congress made the policy decision that for a limited number of industries, including "pipelines transporting gas, oil, or products thereof," limited partnerships should operate without taxation to encourage investment in those critical industries. *Id.* § 7704(d)(1)(E). SFPP argues that because Congress singled out a narrow category of enterprises with the intent to facilitate investment in such enterprises by providing a tax-efficient means to raise capital, FERC's policy is inconsistent with congressional intent because it provides a smaller incentive than would be the case if it granted an allowance for phantom taxes based on all unit holders instead of simply the corporate ones. This is a classic case of an argument proving too much.

SFPP's argument would equally apply to any decision by the Commission that caused the pipeline lower allowances rather than higher. Unsurprisingly, SFPP is able to offer no precedent for the proposition that we should compel the Commission, or any other agency, to adopt a rate structure bringing it into line with the perceived intent of Congress to achieve objectives in general, as opposed to consistency with the mandate adopted by Congress in furtherance of such objectives. As we have noted in other contexts, congressional mandates to agencies to carry out "specific statutory directives define[] the relevant functions of [the agency] in a particular area." *Michigan v. EPA*, 348 U.S. App. D.C. 6, 348 U.S. App. D.C. 7, 268 F.3d 1075, 1084 (D.C. Cir. 2001). Such a mandate does not create for the agency "a

roving commission" to achieve those or "any other laudable goal." *Id.* The mandate of Congress in the tax amendment was exhausted when the pipeline limited partnership was exempted from corporate taxation. It did not empower FERC to do anything, let alone to create an allowance for fictitious taxes.

For the reasons set forth above, we vacate the tax-allowance portion of the FERC opinion and order allowing recovery for income taxes not incurred and not paid.

2. *Litigation Costs*

This case has been an expensive one. At the time of the ALJ Decision, 80 FERC P 63,014, SFPP sought to recover $15.1 million for litigation expenses and associated costs related to Commission and certain civil litigation. This included a $12 million litigation expenses reserve plus $3.1 million that SFPP claimed was a direct expense associated with this rate proceeding and related civil litigation. By the time this case reached its second rehearing in 2001, Opinion No. 435-B, SFPP's actual costs appear to have ballooned much higher; the pipeline's 2002 compliance filing places its cumulative costs litigating this rate proceeding, as well as litigating and settling related civil litigation, at over $48.1 million.

a. *Rate Litigation*

In keeping with *Iroquois Gas Transmission Sys. v. FERC*, 330 U.S. App. D.C. 271, 145 F.3d 398 (D.C. Cir. 1998), and its own precedents, the Commission considered SFPP's rate litigation to be "part of its normal, ongoing operations" and allowed SFPP to recover these costs from shippers. It did not, however, permit recovery through a permanent rate

increase. Reasoning that SFPP's regulatory litigation costs, if "included in embedded rates," would "artificially inflate the level of rates between rate cases," because the rate proceeding that caused most of the costs was now over and was not likely soon to recur, the Commission refused to factor them into SFPP's indexed rates. Instead, the Commission allowed SFPP to recover its actual regulatory litigation costs in the form of an amortized five-year surcharge, with recovery of costs incurred after the 1994 test year offset by the amount which SFPP had collected in excess of the just and reasonable rates from shippers that did not file complaints within the appropriate period. The court reviews, therefore, two distinct decisions of the Commission: to use a temporary surcharge in lieu of a rate increase to recover SFPP's rate litigation costs, and to offset the post-1994 surcharge by the amount of reparations that would have been due non-complaining shippers.

No party challenges the Commission's decision that SFPP's rate litigation costs are recoverable. This does not mean, however, that SFPP was automatically entitled to have those expenses treated as part of its indexed rates, as if the unusually high costs it incurred in this proceeding would regularly recur until the next rate proceeding. SFPP contends that it was entitled to have a litigation reserve factored into its cost of service, because it incurred significant regulatory litigation expenses in the test year, 1994, and was bound to continue to incur costs litigating matters before the Commission in the future. Yet nothing in the record suggests that any other matters SFPP has pending before the Commission will generate costs close to those in this rate proceeding. A glance at SFPP's compliance filing confirms that its litigation expenses have dropped significantly from the levels they reached between 1994 and 1997. The Commission's reasoning for denying the rate increase, that

there was "no assurance that SFPP's litigation costs would exceed $2,914,114 a year for the several years that the 1994 rates are likely to remain in effect," Opinion No. 435-B, 96 FERC at 62,075, seems quite reasonable. The Commission has not denied all recovery of these costs but simply limited SFPP's recovery to its actual costs defending this proceeding and required that those costs be removed from rates once they were repaid.

Where the Commission took a more novel approach was in how it implemented this surcharge. While SFPP was permitted to recover its 1993 and 1994 regulatory litigation costs in full, the Commission offset the surcharge for later years by the amount SFPP had collected, in excess of rates ultimately set by the Commission, from shippers that did not challenge the rates and were therefore not entitled to reparations. SFPP contends that this novel approach of deducting "unclaimed reparations" from the surcharge deprived it of a full recovery, because, in effect, it recovered nothing at all for litigation costs incurred after the test year.

Although the Commission does not cite any precedent for this offset, the apparent novelty of this approach does not render it unreasonable. As the Commission noted, the costs of this proceeding were "high for all parties," and the issue is "how those costs can be most equitably allocated." *Id.* at 62,074. In setting prospective rates, the Commission could reasonably conclude that because SFPP had reaped a windfall by charging rates in excess of those ultimately deemed just and reasonable in the same past years for which it was claiming supplemental expenses above those it would prospectively incur as part of its cost of service, it should be required to first fund its litigation expenses out of that pool before it could begin charging those costs to its customers anew. While SFPP contends that this unfairly benefits

shippers that sat on their rights by not filing complaints against SFPP's rates, and that Section 16 of the ICA only authorizes reparations for shippers who have filed such challenges, *see* 49 U.S.C. app. § 16(1) (1988), it presents no justification for being entitled to keep this windfall. The court therefore affirms the Commission's surcharge mechanism and its corresponding offset, subject to the qualification that, depending on what rates ultimately result from this proceeding on remand, the surcharge might require recalculation.

b. *Civil Litigation Expenses*

SFPP also challenges the Commission's decision to disallow recovery in the East Line rates of significant expenses SFPP incurred in civil litigation defending its reversal of flow on a segment of six-inch pipe running between Phoenix and Tucson. SFPP's flow reversal removed capacity from the East Line in order to allocate it to the West Line. While this benefitted West Line shippers, it would be, as the Commission recognized, inequitable to include these costs in the East Line rates, for "there appears no reason why ratepayers should bear the expense of defending conduct that had no *ex ante* prospect of benefitting them." *See Iroquois Gas*, 145 F.3d at 401; *see also Mountain States Telephone & Telegraph Co. v. FCC*, 291 U.S. App. D.C. 207, 939 F.2d 1035, 1043 (D.C. Cir. 1991) ("*Mountain States I*"). The Commission's recognition that litigation of this sort lacks the requisite nexus to the provision of SFPP's East Line service to justify inclusion in those rates was not unreasonable.

SFPP was embroiled in lengthy litigation in Arizona and Texas state courts with EPR and Navajo, two East Line shippers, regarding SFPP's reversal of flow on the six-inch line, one of SFPP's two pipes running between Phoenix and

Tucson. That litigation ultimately cost SFPP, according to its 2002 compliance filing, over $23.7 million. SFPP also has an eight-inch pipe running between the two cities. The six-inch line had been in West Line service from 1989 to 1991. When SFPP undertook an expansion of the eight-inch line (which had been in East Line service) SFPP temporarily assigned the six-inch line to the East Line. Upon completion of the expansion project, SFPP entered an agreement with ARCO, a West Line shipper, to return the six-inch line to West Line service, thus restoring West Line service to Tucson. EPR and Navajo sued to enjoin the reversal, alleging that SFPP had contractually agreed to provide them the extra capacity, that they had engaged in costly investments in reliance on those agreements, and that the line reversal was motivated by a desire to drive the two shippers out of business. As noted, EPR also filed a complaint with the Commission challenging both the flow reversal and SFPP's East Line rates, thereby initiating this rate proceeding. The ALJ dismissed the portion of EPR's complaint dealing with the flow reversal for lack of jurisdiction, noting that because the Commission has no jurisdiction to prevent SFPP from abandoning service on the six-inch line, it also lacks authority to adjudicate allocation disputes as between shippers serving different markets along the line. ALJ Decision, 80 FERC at 65,161-64. No party has sought review of that ruling. The litigation then proceeded in other courts with SFPP ultimately entering into settlements with both shippers.

The ELS' lawsuit based on SFPP's reallocation of capacity from the East Line to the West Line, and the corresponding litigation costs incurred by SFPP, while caused, in the immediate sense, by ELS, were not costs of East Line service or expenditures benefitting the SFPP system generally. They were costs, if anything, of making capacity available to the West Line at the East Line's expense. SFPP

did not seek to recover its costs from West Line shippers, either in the cost of service or by capitalizing them into the rate base, presumably because of the Commission's earlier ruling that the West Line rates were grandfathered under Section 1803 of the EPAct, and therefore not subject to increase in this proceeding. Instead, SFPP sought to recover them from East Line shippers.

The Commission rejected this attempt, concluding that SFPP's costs in settling these matters "arose out of litigation unique to the conditions of [EPR and Navajo]," and, as such, were not costs that related to the provision of East Line service as a whole. Opinion No. 435, 86 FERC at 61,106. On rehearing, the Commission ruled that the costs of litigating these matters were not recoverable, because "civil litigation of this type" involving "assertions of anti-competitive behavior and breach of contract to make capacity available" does not "address legal costs and remedies that SFPP would normally incur in the conduct of its common carrier operations." Opinion No. 435-A, 91 FERC at 61,513. Therefore, the Commission concluded, SFPP's litigation expenses were "extraordinary." *Id.* On further rehearing, the Commission reaffirmed its ruling that SFPP could not recover such litigation costs in its rates. Opinion No. 435-B, 96 FERC at 62,070.

Under the Commission's accounting regulations, extraordinary costs are defined as costs that "possess a high degree of abnormality and [are] of a type clearly unrelated to, or only incidentally related to the ordinary and typical activities of the entity" and are "not reasonably expected to recur in the in the foreseeable future," 18 C.F.R. pt. 352, General Instructions, 1-6(a). SFPP's flow reversal was not itself unique, for it had changed the direction of flow on the six-inch line a year before during the expansion of the eight-

inch line. Nevertheless, as none of these prior reversals had generated legal disputes of this scope, the Commission could reasonably conclude that this type of civil litigation, "an action that would not arise in the normal course of the pipeline's operations," was not likely to recur. Opinion No. 435-B, 96 FERC at 62,070.

The remaining question is whether the Commission used the correct standard in determining that these costs were "clearly unrelated to, or only incidentally related to the ordinary and typical activities of the entity." SFPP contends that any reading of this portion of the Commission's regulations must comply with *Iroquois Gas*, 330 U.S. App. D.C. 271, 145 F.3d 398, and *Mountain States Tel. & Tel. Co. v. FCC*, 939 F.2d 1021, 1034, particularly the latter decision's admonition that "if expenses are properly incurred, they must be allowed as part of the composition of rates. Otherwise, the so-called allowance of a return upon the investment, being an amount over and above the expenses, would be a farce." *Mountain States,* 939 F.2d 1021 at 1029 (internal citations omitted).

SFPP's position that capacity allocation litigation is an inevitable cost of doing business with two shipper camps competing for the same markets is not without some persuasiveness. The court has generally taken a somewhat broad view of which litigation costs entities regulated under rate-of-return ratemaking should be permitted to recover. In *Iroquois Gas*, the court vacated the Commission's presumptive disallowance of a gas pipeline's litigation costs defending alleged environmental violations during construction, reasoning that the Commission must analyze whether the purported environmental violations were for ratepayers' benefit rather than simply presuming the imprudence of supposedly illegal activity. 145 F.3d at 399-

403. Similarly, in *Mountain States I*, 939 F.2d at 1029-35, the court vacated an FCC order denying a carrier's recovery of antitrust litigation expenses, and, the same term, in *Mountain States Telephone and Telegraph Co. v. FCC*, 291 U.S. App. D.C. 207, 939 F.2d 1035 (D.C. Cir. 1991) ("*Mountain States II*"), remanded a rule presumptively denying recovery of litigation and judgment costs resulting from findings of illegal activity, expressing concern that such a rule might discourage utilities from taking appropriate legal risks that would ultimately benefit their ratepayers. *Id.* at 1042-47.

The Commission stated that it did not consider *Iroquois Gas* apposite because in that case, the underlying activity -- construction of the pipeline pursuant to the Commission's certificate authority -- was something over which the Commission had jurisdiction and whose prudence the Commission could evaluate. Opinion No. 435-B, 96 FERC at 62,070-71. By contrast, the Commission viewed SFPP's underlying business decision to reverse flow on the six-inch line as "beyond the Commission's remedial authority." Proceeding on the premise that it lacks jurisdiction over market entry and exit, the Commission apparently takes the position that it is incapable of evaluating the prudence of legal expenses incurred in the course of either, and therefore cannot include them in common carrier rates.

The salient criterion under *Iroquois Gas* and *Mountain States II* for the recovery of legal expenditures by regulated entities is whether the underlying activity being defended in the litigation serves the interests of ratepayers. *See Iroquois Gas*, 145 F.3d at 401-02; *Mountain States II*, 939 F.2d at 1043-47. The court need not address whether the Commission can reasonably deny the recovery of all nonjurisdictional litigation expenses associated with "both [market] entry and exit by the pipeline," Opinion No. 435-96 FERC at 62,070,

because the issue in this proceeding is more narrow, and arises only with regard to the inclusion of market exit costs in the East Line rates, not market entry costs in the West Line rates. Whatever might be a common carrier's entitlement to recover any nonjurisdictional litigation costs associated with the initiation of common carrier service, it is not unreasonable for the Commission to refuse to allow a common carrier to charge ratepayers for the cost of taking capacity away from them. The Commission's initial determination that the flow-reversal litigation at issue was unrelated to the provision of East Line service was reasonable, and we affirm on that basis. The Commission recognized that, unlike in *Iroquois Gas*, SFPP's litigation did not "arise[] under regulatory obligations that apply to the system as a whole," and noted the "common sense observation by the East Line shippers that the costs and awards relating to their litigation will be borne primarily by themselves if the litigation and settlement costs are included in the East Line rates." *Id.* at 62,071. As only the East Line rates were at issue, the court understands the Commission's statement, that SFPP's civil legal expenses arising from the reversal dispute are not those "that SFPP would normally incur in the conduct of its common carrier operations," to refer narrowly to SFPP's "common carrier operations" on the East Line, and not more broadly to SFPP's "common carrier operations" generally. This approach is reasonable, because the cost of cancelling service is not a cost of providing it.

c. *Allocation of litigation costs*

More problematic is the Commission's decision that the East Line rates should bear half of SFPP's recoverable litigation costs. Opinion No. 435-A, 91 FERC at 61,513. The rate proceeding included both East Line rates and the dispute about whether West Line rates were grandfathered. Some litigation costs may have been exclusive to each line, whereas

others were common, but the record does not contain precise information regarding how much of SFPP's legal expenses can be attributed to each portion of the rate litigation. The West Line accounts for roughly twice the throughput of the East Line, and the Commission had initially reasoned that due to the more complex nature of the West Line issues litigated in the regulatory proceeding, costs should be apportioned volumetrically between the lines. Opinion No. 435, 86 FERC at 61,106. On rehearing, the Commission reversed itself and split the costs evenly. Opinion No. 435-A, 91 FERC at 61,512. The Commission stated that the ALJ, who initially presided over the case, was "in a position to observe complexity and flow" of the litigation, and could have reasonably concluded that it was the East Line issues, not the West Line issues, that accounted for the "greater portion" of costs generated in the proceeding. *Id.*

The ELS contend that the Commission departed from its well-established volumetric allocation policy for general costs without a rational basis, and thus was arbitrary and capricious in basing its allocation on which shippers created higher litigation costs. We see nothing problematic in an approach that attributes litigation costs to those for whose benefit the litigation is incurred, and prior Commission cases dealing with legal expenses have allocated them similarly. *See, e.g., Southern California Edison Co.*, 56 FERC P 61,003, 61,021 (1991). A volumetric approach might be appropriate for the recovery of commonly-incurred costs benefitting the entire system, but the Commission's focus here on who "generated the greater portion of a given litigation," Opinion No. 435-A, 91 FERC at 61,513, is reasonable when litigation costs are specific to separately priced services.

The problem with the Commission's litigation-cost allocation is more basic: it lacks substantive analysis. The

court is unable to discern why the Commission decided that 50%, as opposed to 40%, 30%, or any other number, fairly reflects the portion of SFPP's litigation expenses attributable to the East Line. It simply claimed to rely on the ALJ Decision for the 50% figure. *See* 80 FERC at 65,167. The ALJ Decision, at best, implicitly adopts the allocation suggested by a Staff witness. Other than describing the Staff's proposal as being developed as a representative amount of litigation expenses for inclusion in the test year cost of service, the ALJ Decision provides no analysis of why such a distribution is warranted. Hence, the Commission's reliance on the ALJ as being in the best position to observe the "complexity and flow" of the litigation leaves unexplained the basis for the allocation. While most of SFPP's litigation cost recovery has been offset by unpaid reparations, and the difference in rates resulting from the allocation may ultimately not be significant, the Commission must still explain its decision. The 50% allocation may or may not be a fair reflection of SFPP's rate litigation costs that were in fact attributable to the East Line. Accordingly, we remand for the Commission to explain its rationale for its allocation, either based on a 50-50 sharing between the East and West Lines or any other allocation it determines would be appropriate.

3. *Reconditioning Costs*

SFPP sought to have included in its East Line rates a projected annual cost of $3 million for a 15-year pipeline reconditioning program replacing the protective coating on parts of the East Line. Before the Commission, SFPP claimed to have spent upwards of $5.9 million of these reconditioning costs between 1995 and 1998. While acknowledging SFPP's expenditures on the project, the Commission refused to incorporate those costs, most of which were not incurred until after 1995, into SFPP's cost of service because they were too

uncertain at the end of the test period in 1994. Opinion No. 435, 86 FERC at 61,106-08. On rehearing, the Commission permitted SFPP to recover its actual expenses from shippers as part of the temporary surcharge it created for SFPP's rate litigation and environmental expenses. Opinion No. 435-A, 91 FERC at 61,518-19. On further rehearing, however, the Commission reversed itself again and denied SFPP all recovery of its refurbishing costs. Opinion No. 435-B, 96 FERC at 62,078-79.

Under its cost of service regulations, the Commission uses a "test year" methodology to determine a pipeline's annual cost of service. This approach looks to the actual costs the carrier incurs in the "test year" and then adjusts for any "known and measurable with reasonably accuracy" costs that "will become effective within nine months after the last month of the available actual experience utilized in the filing." 18 C.F.R. § 346.2(a)(1)(ii) (2004). The test year methodology accounts for the somewhat counterintuitive quality of these proceedings. The Commission, in issuing decisions after 1999 setting SFPP's cost of service for years after 1994, looked not to SFPP's actual costs in those years but rather to what one could have predicted those costs to be, based on what was known in 1994. The Commission noted in Opinion No. 435 that it considers the test year a "relatively rigid concept simply because there must be some point at which the record closes and there is a known, factual basis for the conclusions." 86 FERC at 61,108. Although this statement appears to mark a change from Commission policy in cases preceding the implementation of its cost of service regulations, where it indicated that it would approach test years more flexibly, *see, e.g., Lakehead,* 71 FERC at 62,313; *Williams Pipe Line Co.*, 21 FERC at 61,658, the Commission's current cost of service regulations provide that

it "may allow reasonable deviation from the test period" for "good cause shown." 18 C.F.R. § 346.2(a)(1)(ii).

The ALJ, using 1993 as the base year, decided that the refurbishing costs could not be recovered as part of SFPP's cost of service because the costs had not yet been incurred at that time, and SFPP's predictions of future costs were too uncertain. Finding that SFPP's board had not committed to the refurbishing program as late as 1995 and was simply funding the program year-by-year rather than committing itself to the entire proposed 15-year program, the ALJ reached a series of conclusions: that SFPP might decide to abandon the project or scale it back in the future, that the overall plan was subject to change, that there was little documentation to support estimates of the costs, and that it was uncertain whether significant amounts of the pipeline scheduled for refurbishing might be so corroded as to require outright replacement, which would be treated as a capital investment and factored into the rate base, not as an expense added to cost of service. In Opinion No. 435, the Commission essentially affirmed the ALJ's decision. 86 FERC at 61,106-08.

SFPP contends that the Commission, which used a 1994 base period and the nine-month test period in 1995, could not reasonably affirm the ALJ's decision, which was based on data from an earlier period. There is some record evidence supporting SFPP's claim that it had more firmly committed to the reconditioning project, including beginning refurbishment of several miles of pipeline in 1995, within "nine months after the last month" of 1994. *Cf.* 18 C.F.R. § 346.2(a)(1)(ii). There was testimony that SFPP's board had approved the project by 1994, that SFPP had recoated 13 miles of the pipeline in 1995, and that its prospective cost estimates were based upon its actual costs thus far.

Nonetheless, it was not unreasonable of the Commission to continue to have doubts about locking so large an expense into SFPP's cost of service (or, to put it more aptly given the test year methodology used here, it was not unreasonable for the Commission to have thought that doubts about the scope of the reconditioning project would still have been proper in 1995). At most the evidence before the Commission showed that, by 995, SFPP had begun refurbishing certain portions of its pipeline; there was no guarantee from SFPP that the refurbishing would be as ambitious and expensive as claimed. Embedding SFPP's projections into its cost of service would have required its customers to pay for the refurbishing even if the project ultimately resulted in far smaller expenditures than those SFPP had projected. Indeed, given that SFPP now claims to have spent roughly $6 million on the project over four years, when it had predicted costs of at least $3 million a year over fifteen years, the Commission's judgment has been validated by hindsight.

This does not end our inquiry, however, for SFPP also contends that having denied inclusion of reconditioning costs in SFPP's cost of service, it was arbitrary for the Commission not to permit recovery in a surcharge of SFPP's actual costs in 1995-98, which were not found to be imprudently incurred. The Commission's legitimate doubts over the ultimate scope and cost of the reconditioning do not explain the basis for the Commission's decision to deny recovery once actual costs of the project were known. Its decision, rather, stems from a combination of the Commission's test year approach and its interpretation of the filed rate doctrine. In Opinion No. 435-A, the Commission permitted SFPP to recover its actual reconditioning costs as part of the same surcharge whereby it permitted recovery of SFPP's regulatory litigation costs, similarly offset by any unpaid reparations; any cost not so offset could be included in a surcharge amortized over five

years. Yet in Opinion No. 435-B, presented with SFPP's claim that it had expended $5.9 million in actual East Line refurbishing costs between 1995 and 1998, the Commission denied recovery altogether because the expenditures "were not incurred in the 1994 cost of service test period." 96 FERC at 62,078. In responding to protests that its Opinion No. 435-A ruling violated the filed rate doctrine, the Commission concluded "upon further review" that allowing a surcharge for costs not incurred in the test period or with any regularity thereafter "would permit SFPP to recover costs after the fact which were not even present in the test year itself and which thereafter could not be recovered in a cost of service rate filing," and that "to do so after the fact raises serious questions under the filed rate doctrine." Opinion No. 435-B, 96 FERC at 62,078.

The difficulty for the court stems from three sources: the Commission's apparent failure in its test year approach to articulate a clear and consistent approach for dealing with the prudently incurred costs of providing pipeline service that do not regularly recur, the Commission's failure to explain adequately why SFPP's reconditioning costs would not be recoverable in a cost of service rate filing, and its failure to articulate why such a surcharge would violate the filed rate doctrine. Some prudent expenditures involved in the operation of a pipeline that are not capitalized, such as, for instance, rate litigation or refurbishing, are bound to be one-time or infrequent expenditures. A "test year" snapshot of a pipeline's operating costs, therefore, if applied too simplistically, risks over- or under-stating the "real" costs of providing pipeline service, depending on whether such costs happen, by chance, to fall in a test year or not. We do not understand the Commission to apply the test year concept so simplistically; its regulations deal with the possible overstating problem by disallowing nonrecurring costs as part of the cost of service,

see 18 C.F.R. § 346.2(a)(1)(I), and both under- and over-stating problems by permitting deviation from the test year "for good cause shown," *id.* § 346.2(a)(1)(ii). Yet the Commission's approach in the instant case does not appear to deal consistently with costs incurred outside the test year, as evidenced by its different treatment of SFPP's rate litigation and reconditioning costs between 1995 and 1998. Both appear to be prudent, otherwise recoverable costs; both are nonrecurring (in the sense that they will not be permanent expenditures SFPP can be expected to incur each year); both were incurred chiefly outside the 1994 test year; and the Commission initially held that both past expenses could be recovered in prospective rates through a temporary surcharge because of "benefits that flowed to the system when the costs were incurred." Opinion No. 435-A, 91 FERC at 61,518.

The Commission then reversed course in Opinion No. 435-B and disallowed recovery of the reconditioning costs only. Its reasoning for disallowing one surcharge but permitting the other was that "unlike the [Commission] regulatory costs, none of [SFPP's reconditioning costs] were incurred in the test period." 96 FERC at 62,078. The rate litigation surcharge included SFPP's actual costs after 1994. So the Commission's ruling suggests that it matters, to recovery of costs incurred outside of the test year, whether a carrier also incurred costs of the same general nature in the test year itself. The logic behind this distinction, as applied to costs that benefit the carrier's system but are not expected to regularly recur, is neither explained in Opinion No. 435-B itself, nor is it obvious. Should the Commission wish to rely on this reasoning on remand, it must articulate and justify more carefully what its policy on the recoverability of non-test-year expenses is.

The Commission did explain that SFPP's rates were indexed to account for cost increases after the test year, and that SFPP could not meet the "substantial divergence" standard for showing that indexing failed to account for increases in its cost of service due to reconditioning expenses after 1994. *Cf.* 18 C.F.R. § 342.4(a) (2004). Assuming that the Commission can explain its different treatment of rate litigation and reconditioning costs incurred in years after the 1994 test year, this may be a reasonable basis for denying recovery, but the Commission's opinion provides no analysis for why it is true. Where the Commission had found SFPP's cost of service to be roughly $14 million a year, SFPP was claiming reconditioning costs of roughly $1 million a year, a not insubstantial amount. The Commission provided no estimate or analysis of how any supplemental revenues to SFPP resulting from rate indexing, or from increased throughput in years after 1994, compare to those expenses.

The Commission also stated that permitting recovery of the refurbishing costs "after the fact" would "raise serious questions under the filed rate doctrine." Opinion No. 435-B, 96 FERC at 62,078. The filed rate doctrine "forbids a regulated entity to charge rates for its services other than those properly filed with the appropriate federal regulatory authority." *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577, 101 S. Ct. 2925, 69 L. Ed. 2d 856 (1981). The Commission did not articulate what type of "serious questions" it thought such recovery would raise. Because a prospective surcharge would presumably be on file with the Commission, the court presumes that the Commission meant that an amortized surcharge, by prospectively recovering SFPP's expenses from past years, would violate the related rule against retroactive ratemaking, which requires that "a utility may not set rates to recoup past losses, nor may the Commission prescribe rates on that principle." *Southern*

California Edison Co. v. FERC, 256 U.S. App. D.C. 364, 805 F.2d 1068, 1070 n.2 (D.C. Cir. 1986) (quoting *Nader v. FCC,* 172 U.S. App. D.C. 1, 520 F.2d 182, 202 (D.C. Cir. 1975)).

This logic, again, raises the question of why such recovery is any more permissible for rate litigation expenses than it is for reconditioning costs. The Commission seems to place SFPP in a Catch-22: it cannot recover its reconditioning costs prospectively or contemporaneously because the cost of the project is too uncertain until the costs are incurred, but then once the costs are certain it is too late because recovery would involve retroactive charges. Absent a better explanation for the Commission's conclusion that SFPP has recovered its reconditioning costs through the indexed rates, it is unclear how the costs of any multi-year project whose cost is not "known and measurable with reasonable certainty" in advance, 18 C.F.R. § 346.2(a)(1)(ii), could ever be recovered, were this reasoning to be consistently adopted. The Commission ruled in Opinion No. 435-A that prospective recovery of SFPP's reconditioning costs would be appropriate because of "benefits that flowed to the system when the costs were incurred," 91 FERC at 61,518, implying that it initially did not view the rule against retroactive rulemaking as an obstacle because the expenses provided an ongoing benefit that would continue to accrue in future years. In light of the Commission's failure to explain why it now considers the rule against retroactive rulemaking (or the filed rate doctrine) to bar recovery, and because no party has briefed this question in any detail, the court remands so that the Commission, if it wishes to continue relying on this reasoning, may better explain it.

The Commission may have answers to these concerns, but they are not provided in the Opinions on review. SFPP's

shippers are presently enjoying the benefits of what appears to be an expensive pipeline reconditioning program without sharing in any of its costs. If, in the Commission's opinion, they should not have to, the Commission needs to provide a more thorough explanation of why not. Accordingly, we remand SFPP's request to recover its reconditioning costs for the East Line between 1995 and 1998 to the Commission for further consideration.

III. Reparations

A. *Background and Proceedings Below*

After determining that SFPP's East Line rates were not just and reasonable, the ALJ ordered SFPP to pay reparations to the ELS which had filed complaints against the rates. ALJ Decision, 80 FERC at 61,308. In Opinion No. 435, the Commission considered various objections to the reparations on the part of both SFPP and the shippers but reaffirmed that SFPP was to pay reparations as determined by the Commission. *See id.* at 61,111-14. Specifically, the Commission ruled that the period for the calculation of reparations would run from the date of each complaint until March 31, 1999, the effective date of revised East Line rates required by Opinion No. 435.

In calculating the potential reparations, the Commission retroactively applied the test year approach it had used to set SFPP's prospective rates: SFPP was to develop an East Line cost of service for a test year, 1994; design a rate that reflected that cost of service; index that rate to December 31, 1998; and apply that indexed rate to designated volumes adopted by Opinion No. 435 for each calendar year for which an indexed rate had been developed. Using the new cost of service thus established for years 1994-1998 and partial year

1999, SFPP was to determine whether the revenues for each period resulted in an over or under-recovery of its cost of service. FERC's order permitted SFPP to "net out its over and under recoveries for each year and determine that net amount, if any, that is due its East Line Shippers." *Id.* at 61,114. FERC ordered a similar calculation of reparations for years prior to 1994 based on the calculation of under- or over-recovery of cost of service in those years. As to reparations in general, FERC held that no shipper was entitled to reparations for periods prior to the filing date of a complaint. *Id.* at 61,112-13.

On rehearing, FERC held that Navajo was the only complainant that had filed a challenge to East Line rates. Thus, only Navajo could recover reparations. Opinion No. 435-A, 91 FERC at 61,514. FERC granted Navajo reparations beginning one month prior to the filing of its December 23, 1993, complaint to SFPP's rates. FERC also noted that Navajo had entered a settlement with SFPP in 1989. That settlement barred Navajo from bringing action against SFPP until November 23, 1993. With those provisos, FERC ordered SFPP to calculate the limited reparations still in order on the East Line based on the difference between per-barrel rates charged and per-barrel rates that would have been charged had SFPP charged cost-based rates using a 1994 test year, and to index such rates annually going forward -- in other words, the difference between the charged rates and the rates that SFPP should have charged. In sum, the Commission modified its prior order and decreed that:

> SFPP will calculate the gross reparations that would be due if all shippers that had used the East Line had filed complaints for the applicable reparations period ... establishing the total revenue that was received in excess of the new East Line rates established by the

> prior order. Navajo will be paid its *pro rata* share of the reparations for the relevant time frame.

Id. at 61,518. The Commission noted that because Navajo was the only shipper entitled to reparations, the calculations "should leave a surplus of revenues in excess of the East Line restated cost of service between the beginning of the reparations period and the actual date on which the restated rates began to be collected by SFPP." *Id.*

The shippers petitioned for rehearing of FERC's reconsideration order, which FERC granted in part. This time, FERC held that Chevron, Western, ConocoPhillips, and ExxonMobil were, like Navajo, entitled to reparations for over-charges that occurred two years prior to the filing of their complaints. Opinion No. 435-B, 96 FERC at 62,071-74. FERC held that Valero was not entitled to reparations, because its complaint was filed after August 7, 1995, the last date complaints were consolidated in the proceedings. *Id.* at 62,072. The Commission subsequently clarified Opinion No. 435-B by stating that Chevron's eligibility for reparations was determined as of its August 3, 1993 complaint, not a protest it filed September 23, 1992. Clarification and Rehearing Order, 97 FERC P 61,138.

SFPP now argues that the Commission ought not have awarded any reparations whatsoever. Navajo contends that it was improperly denied reparations prior to November 23, 1993. Chevron alleges that FERC improperly set the commencement date for calculating its reparations. And Valero, BP WCP, and Chevron all claim that they were improperly denied reparations.

B. *Analysis*

1. *SFPP*

SFPP argues that the underlying orders were arbitrary and capricious for four related reasons. First, SFPP contends that awarding ELS reparations is impermissible retro-active ratemaking, in violation of the Supreme Court's decision in *Arizona Grocery Co. v. Atchison, Topeka & Santa Fe Railway Co.*, 284 U.S. 370, 52 S. Ct. 183, 76 L. Ed. 348 (1932). Second, it asserts that FERC's award of pre-complaint reparations violates the EPAct. Third, SFPP advances that FERC improperly awarded reparations based on a "test period," disregarding damages actually suffered and proved by complainants. Finally, SFPP argues that FERC failed to consider substantial arguments -- such as the novelty and complexity of SFPP's rate case -- that militated against awarding reparations. For the reasons stated below, we reject all four claims.

a. *The* Arizona Grocery *Rule*

Arizona Grocery proscribes "the retroactive revision of established rates through ex post reparations." *Verizon Tel. Cos. v. FCC*, 348 U.S. App. D.C. 98, 269 F.3d 1098, 1107 (D.C. Cir. 2001); *see also Ala. Power Co. v. ICC*, 271 U.S. App. D.C. 394, 852 F.2d 1361, 1373 (D.C. Cir. 1988). Otherwise put, *Arizona Grocery* bars reparations that retroactively change a final Commission-approved rate. SFPP relies on *Arizona Grocery* to argue that Opinion No. 435 was a final order prescribing just and reasonable rates, and thus FERC was barred from awarding reparations when SFPP's rate was effectively further lowered as a result of FERC's subsequent orders. SFPP argues that Opinion No. 435 was a final order setting rates "to be thereafter observed" under

ICA Section 15(1), and therefore that the subsequent orders were retroactive changes of Opinion No. 435. We disagree.

Arizona Grocery is of no help to SFPP in this case. *Arizona Grocery* applies only where the Commission has "declared what is the maximum reasonable rate to be charged by a carrier." 284 U.S. at 390. Yet FERC did not finalize a maximum reasonable rate in Opinion No. 435 and in fact repeatedly stated it was not doing so. Thus Opinion No. 435 set no final rate; rather, FERC only established a final rate at the completion of the OR92-8 proceedings. *SFPP, L.P.*, 100 FERC P 61,353, 62,625 (2002) ("September 26 Order"). The OR92-8 proceedings were compliance filings. SFPP's filing in Docket No. OR92-8-013 showed SFPP's calculations for determining how its East Line rates should be structured to reflect the requirements of Opinion No. 435-B. SFPP later amended that in Docket No. OR92-8-015 to address the exclusion of the interest element from the calculation of the total potential reparation pool that would be due under the Commission's prior orders. *Id.* at 62,622.

The record shows that at each point, the Commission said that final East Line rates would not be established until the OR92-8 proceedings were completed. September 26 Order, 100 FERC at 62,625. In response to Opinion No. 435, SFPP filed a tariff establishing a rate, but the Commission concluded that the tariff could not be determined to be just and reasonable until review of the Docket No. OR92-8 compliance filing was completed. The Commission accepted the tariff for filing and suspended it, subject to refund, pending review of the compliance filing. *SFPP, L.P.*, 87 FERC P 61,056, 61,225-26 (1999). Nor did FERC's next opinion on the subject make that rate final. Opinion No. 435-A merely reaffirmed the suspension of the previously filed tariff based on the significant chance that the proposed rate

levels in it would change depending on how the protests and related requests for rehearing were resolved. 91 FERC at 61,520. It did not finalize the rate.

FERC's subsequent orders concerning SFPP's proposed rates were similarly nonfinal. FERC accepted for filing SFPP's Tariff No. 60, filed to comply with Opinion No. 435-A, with a proposed effective date of August 1, 2000, but suspended it subject to refund. *SFPP, L.P.*, 92 FERC P 61,166, 61,563-64 (2000). Opinion No. 435-B approved the August 1, 2000, effective date because that was the date the Commission accepted SFPP's compliance filing, and directed a further compliance filing, also to be effective August 1, 2000. 96 FERC at 62,071, 62,079. SFPP filed Tariff No. 67 (later corrected in Tariff No. 68), with a proposed effective date of December 1, 2001. *SFPP, L.P.*, 98 FERC P 61,177, 61,657 (2002). The Director of the Division of Tariffs and Rates Central rejected the tariffs because Opinion No. 435-B required an effective date of August 1, 2000. *Id.* FERC's order memorializing the rejection made clear that FERC's previous orders suspended, subject to refund, SFPP's proposed tariffs

> pending resolution of the numerous compliance issues that have been raised in the course of these proceedings. In each of the prior Opinions the Commission has made clear that SFPP must recalculate the rates to be applied in compliance with those Opinions and that any prior calculations of reparations and surcharges must be adjusted accordingly.

Id.

The Commission has thus been clear from the outset and throughout that no final rate determination would be made until the OR92-8 proceedings were complete. September 26 Order, 100 FERC at 62,625. As a result, the Commission's orders requiring reparations do not violate the prohibition in *Arizona Grocery* from subjecting a carrier to payment of reparations with respect to a final rate. The Commission did not establish final lawful rates where it has expressly reserved authority to make adjustments in the context of an ongoing proceeding in which the methodology for determining the rate had not even been established. *Id.* at 62,626.

SFPP contends that the Commission's reparations orders violate ICA Section 15(7), which authorizes refunds of "such increased rates or charges" as "shall be found not justified." 49 U.S.C. app. § 15(7) (1988). But Section 15(7) is an authorization, not a prohibition, and FERC did not invoke this provision in awarding the shippers reparations. The Commission found it inappropriate for this complaint proceeding to go forward under Section 15(7), *SFPP, L.P.*, 63 FERC P 61,014, 61,124 (1993), and thus no relief was awarded under that section. Rather, FERC proceeded under ICA §§ 8, 9, and 16(1), which specifically authorize the Commission to award damages in a Section 13 complaint. 49 U.S.C. app. §§ 8, 9 & 16(1) (1988). SFPP also contends that FERC lacks authority to issue "interim" rates after ruling on a complaint. Yet nothing in Section 15(1) prohibits FERC from directing a pipeline to file an interim rate, subject to suspension and refund, if there is a possibility that the final rates will be lower than the interim rates. Indeed, the Supreme Court has held that under the ICA the Commission has authority -- in response to an initial rate filing -- to direct an oil pipeline to file interim rates to go into effect, subject to refund, during the suspension period for the initial rates. *Trans Alaska Pipeline Rate Cases*, 436 U.S. 631, 654-56, 98

S. Ct. 2053 56 L. Ed. 2d 591 (1978). *See also FPC v. Tenn. Gas Transmission Co.*, 371 U.S. 145, 146, 9 L. Ed. 2d 199, 83 S. Ct. 211 (1962); *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 585, 62 S. Ct. 736, 86 L. Ed. 1037 (1942).

Therefore, we hold that when the Commission awarded reparations, it was not constrained by *Arizona Grocery*'s blanket prohibition on retroactive repeals of ratemaking.

b. *Pre-Complaint Reparations*

SFPP's second contention is that the EPAct precludes pre-complaint reparations in a Section 13 proceeding, and that each complainant may seek reparations only for overcharges that date from the filing of its own complaint. We disagree. EPAct Section 1803(b) provides:

> If the Commission determines pursuant to a proceeding instituted as a result of a complaint under section 13 of the Interstate Commerce Act that the rate is not just and reasonable, the rate shall not be deemed to be just and reasonable. Any tariff reduction or refunds that may result as an outcome of such a complaint shall be prospective from the date of the filing of the complaint.

EPAct § 1803(b). The ICA, however, allows reparations for up to two years prior to the date of the filing of a complaint if the rates paid in those two years exceed the just and reasonable rate established in the complaint proceeding. *See* 49 U.S.C. app. § 16(3)(b) (1988).

SFPP contends that the last clause of Section 1803(b) is applicable to any and all complaints filed under ICA Section 13, and therefore that reparations awarded for all complaints

-- including those for East Line rates -- must be prospective from the filing of the complaints. We agree with SFPP that EPAct Section 1803(b) prohibits retroactive rate-making, but we think that it does so only for those rates that were "grandfathered" under this section. Section 1803(b) does not apply to complaints challenging non-grandfathered rates. In its prefatory clause, it explicitly refers only to "a complaint ... against a rate deemed just and reasonable under [Section 1803(a)]." The second-to-last sentence of Section 1803(b) expressly relates only to complaints on which FERC acts to determine grandfathered rates, otherwise "deemed to be just and reasonable," to be just and reasonable. The reference to "such a complaint" in the last sentence of Section 1803(b) plainly refers back to the prior references in Section 1803(b) to complaints against rates "deemed to be just and reasonable" under Section 1803(a).

Because the East Line rates were challenged within the one-year period prior to enactment of the EPAct, they are not grandfathered under Section 1803. Accordingly, relief for East Line rate complainants is governed by "the traditional standards of the ICA, including section 16's provision for a two year reparations period retroactive from the date of the complaint." *SFPP, L.P.*, 68 FERC P 61,306, 61,582 (1994).

FERC's order tracked this interpretation of the statute precisely. FERC found that shippers filing a complaint against SFPP's East Line rates may recover reparations for the two-year period prior to the date of their complaints. The Commission determined that the EPAct barred pre-complaint relief only for complaints against grandfathered rates. Thus, FERC correctly found that Section 1803(b) does not apply to complaints challenging the East Line rates that FERC held not to be grandfathered.

c. *Test Period*

Next, SFPP challenges the methodology FERC ordered SFPP to use to calculate reparations. In Opinion No. 435-A, FERC ordered SFPP to use the following method. First, FERC said, SFPP must determine what the just and reasonable rate would have been in each year between 1994 and August 1, 2000 -- as well as two years back from the date of the earliest complaint -- and then calculate what the appropriate gross revenues would have been from that rate. The difference between the gross revenue under the new just and reasonable rates would create the total reparations pool -- the amount SFPP would pay to all eligible shippers. SFPP would then calculate the reparations due each eligible shipper (including interest), leaving a residual in the pool of funds that could not be distributed because certain shippers had not filed a complaint within the time frame of the proceeding. The residual pool would then be credited against the total supplemental costs permitted under Opinion No. 435-A between 1995 and 1998. Any remaining allowable costs would then be recovered through a five-year surcharge.

To estimate what gross revenues would have been in those years, the Commission directed that SFPP use a test year cost of service, divided by the test year's volumes, to replace the previous unit rate not found to be just and reasonable. Opinion No. 435-A, 91 FERC at 61,516. The reparations payment due for each year would be the difference between the revenues generated in that year under the old rates and the revenues that would have been generated under the final new rates. *Id.*

SFPP challenges the estimation methodology proposed by FERC -- specifically FERC's direction to use a "test period" to estimate past gross revenues. SFPP contends that basing the

reparations calculations on a rate derived from a historical test period "makes no sense in the real world, as it wrongly assumes SFPP's actual cost of service did not change appreciably over a period of eight years or more." We once again disagree.

The use of test periods to set the cost of service for rates intended to span a number of years is well established. *See, e.g., Williston Basin Interstate Pipeline Co. v. FERC*, 334 U.S. App. D.C. 109, 165 F.3d 54, 56 (D.C. Cir. 1999). As we have noted, it is ordinarily impossible for a pipeline to know at the time of filing what its actual costs will be during the effective period of the filed rates, and so the use of a "test period" for calculating the cost of service is appropriate. *Id.* While use of a test period is not perfect, it is a reasonable proxy for actual costs. *See generally American Public Power Ass'n v. FPC*, 173 U.S. App. D.C. 36, 522 F.2d 142 (D.C. Cir. 1975); *see also Public Serv. Co. v. FERC*, 832 F.2d 1201, 1218 (10th Cir. 1987). It was therefore reasonable for the Commission to base reparations calculations on the same test period methodology it uses to calculate prospective rates. To the extent SFPP contends that the Commission's reliance on the test year approach unreasonably denied it recovery of certain expenses it incurred after the test period, those concerns are addressed in Part II of our opinion.

The Commission also properly determined that rates based on the test period could be used to calculate reparations for the two years prior to the filing of the complaints. *See* ALJ Decision, 80 FERC at 65,203. There is no basis to conclude that test period rates that are just and reasonable for all future years do not provide a just and reasonable basis for determining reparations in the two years prior to the complaints. *Id.*

SFPP further contends that it should have been allowed to offset under-recovery of its cost of service in some years with over-recovery of its cost of service in other years, based on ICC decisions permitting netting of multi-year data in determining reparations. As explained, however, the Commission reasonably found that consideration of the costs from every year was not feasible. While the Surface Transportation Board (formerly ICC) determines the total revenue stream required to recover the costs of particular service over its economic life, FERC has reasonably decided to calculate reparations by the difference in the unit value of the old and new rate, not the difference in gross and net revenues for the operation of the pipeline as a whole. ALJ Decision, 80 FERC at 65,203. Accordingly, the Commission reasonably found the netting of reparations across the entire reparations period inappropriate in these circumstances.

Moreover, this Court has previously rejected pipeline demands to permit offsetting undercharges and overcharges in different years during a refund period. As we held in *Belco Petroleum Corp. v. FERC*, 191 U.S. App. D.C. 157, 589 F.2d 680, 686-87 (D.C. Cir. 1978), the NGA -- like the ICA here -- gives the regulated entity no right to collect more than the just and reasonable rate in one period simply because it collected less than the just and reasonable rate in another.

SFPP cites a number of cases for the proposition that the concept of netting multi-year data to assure fairness in reparations is well established, but here a multi-year rate method was not employed. It is thus reasonable to base reparations on a year-to-year basis without netting.

d. *Reasoned Decisionmaking*

SFPP's fourth contention is that the Commission abused its discretion by failing to consider SFPP's arguments. Although SFPP acknowledges FERC's discretion to award reparations, it points out that it argued that SFPP's rate case was complex and presented issues of first impression, and that SFPP could not have predicted what lawful rates would have been. In sum, it argued before the Commission that it could not have reasonably adjusted its rates. SFPP claims that by giving no consideration to these arguments, FERC failed to engage in reasoned decisionmaking. We reject this contention.

FERC's orders reasonably addressed SFPP's concerns. Although FERC never explicitly responded to SFPP's point that its case was complex, it implicitly did so by finding SFPP's rates unjust and unreasonable. The fact that SFPP's rate case was complex does not alter the Commission's obligation to make a decision as to whether SFPP's rates were unjust and unreasonable. The Commission reasonably responded to SFPP's argument by simply performing its statutory duty to pass on the reasonableness of SFPP's rates, rather than dwelling on the difficulty of the task at hand. Assuming FERC's decision to find the rates just and reasonable was reasoned, it does not become unreasoned simply because FERC reached its decision without explicitly commenting on its difficulty. In any event, it is apparent from the length and complexity of FERC's discussion that it understood the complexity of SFPP's case.

As for SFPP's argument that it could not have predicted the eventual rates, the Commission expressly responded to that reliance argument by stating that SFPP was on notice that its rates were subject to review, and that "there was a risk

that the rates could be found unjust and unreasonable and reparations awarded." Opinion No. 435, 86 FERC at 61,113.

Accordingly, the Commission engaged in reasoned decisionmaking in awarding reparations. Although certain matters were complex issues of first impression, FERC did not need to acknowledge that complexity explicitly for its decision to stand.

2. *Navajo*

Turning next to the shipper petitioners, Navajo contends that it should be awarded reparations for the two years preceding the filing of its complaint on December 22, 1993. As noted above, the Commission concluded that a prior settlement agreement between SFPP's predecessor and Navajo foreclosed Navajo from collecting reparations for this two-year period. We find no error in FERC's decision.

The settlement Navajo entered into with SFPP's predecessor, provided -- in Section 2.3 -- that:

> For the five (5) year period following the effective date of FERC Tariff No. 88 -- *i.e.*, November 23, 1988 -- Navajo shall not challenge, by complaint or any other means, East Line rates established or increased in conformity with the terms and conditions of this Article, nor shall they seek reparations or other damages with respect to such rates.

Southern Pac. Pipe Lines, Inc., No. IS85-15-000, Stipulation and Settlement Agreement § 2.3 (Jan. 30, 1989) (approved in *Southern Pac. Pipe Lines Partnership, L.P.*, 49 FERC P 61,081 (1989)).

Navajo contends that this language permits it to seek reparations for the two years prior to filing its complaint, even though those two years are within the five-year settlement rate moratorium. In Navajo's view, this reading is compelled by the contrast between Section 2.3 and Section 1.3 of the 1989 settlement concerning West Line rates. Section 1.3 provides as follows:

> During the (5) year period following November 23, 1988 (the effective date of FERC Tariff No. 88), Navajo shall not challenge, by complaint or any other means, West Line rates established or increased in conformity with the terms and conditions of this Article, nor shall they seek reparations or other damages with respect to such rates for any part of that five (5) year period.

Id. § 1.3.

According to Navajo, the last sentence "made clear that Navajo not only agreed to refrain from filing a complaint seeking reparations during the five-year period following November 23, 1988, but also agreed to waive its rights to reparations relating to that five-year period." In contrast, Navajo argues, "the provision pertaining to the East Line did not waive the right to seek reparations for rates paid for service on the East Line during the five-year period once the moratorium expired."

The ALJ disagreed with Navajo, concluding that a "fair reading of the settlement agreement and the Commission's order approving it precludes claims for reparation by Navajo for rates charged during the period when the settlement was in effect." ALJ Decision, 80 FERC at 65,207-08. The Commission affirmed the ALJ's interpretation as "the only

reasonable interpretation" of the settlement agreement. Opinion No. 435, 86 FERC at 61,111.

We find the Commission's interpretation of the settlement to be reasonable. Section 2.3 expressly provides that Navajo shall not "seek reparations or other damages" with respect to the East Line rates for the five-year period following November 23, 1988. *Southern Pac. Pipe Lines, Inc.*, No. IS85-15-000, Stipulation and Settlement Agreement § 2.3 (Jan. 30, 1989). While an additional phrase does appear in Section 1.3, this does not alter the plain meaning of Section 2.3. It is unreasonable to assume that, although obtaining agreement to language expressly referring to a five-year moratorium period for all rate changes, SFPP nevertheless intended to permit Navajo to seek reparations for two of the five years.

Navajo advances a number of theories as to why SFPP might have agreed to a shorter moratorium on East Line reparations. However, there is no evidence that these theories played any part in the negotiations and none of them address the fundamental point that the settlement expressly says five years. The Commission's interpretation of the contract as such is therefore reasonable.

3. *Valero*

Valero, another shipper, contends that FERC erred by denying it reparations in Opinion No. 435-B. Valero argues that because FERC found that SFPP charged it unjust and unreasonable rates in Opinion No. 435-A, FERC had an obligation to award reparations to it as well. FERC responds that because Valero was not a party to OR92-8, the Commission properly rejected Valero's claim that it is entitled to reparations "in the same manner" as the shippers in OR92-

8. Valero may be correct that it is entitled to reparations, but we agree with FERC that it is not so entitled in this particular proceeding.

Valero's complaint involves distinct issues from the complaints at issue in this case, and accordingly FERC reasonably denied it recovery in these proceedings. This case concerns shippers who filed their claims prior to August 1995. The timing of their complaint matters, because FERC determined that they were entitled to reparations only for over-charges during the two years preceding the filing of their complaints. In contrast, Valero -- then Ultramar Diamond Shamrock -- filed its complaint in November 1997. *ARCO Products Co.*, 82 FERC P 61,043, 61,183 (1998). That complaint was docketed as OR98-2, separate from the docket at issue here, OR92-8, consolidated with other complaints filed after August 7, 1995, and all held in abeyance with an opportunity to amend the complaints based on the findings in this proceeding. The post-August 7, 1995 complaints were consolidated in a proceeding separate from OR92-8 because those complaints involve different test periods and cost factors from those addressed in OR92-8. Because Valero filed its complaint in 1997 -- and because, as FERC points out, Valero's reparations will be determined based upon a different test period and cost factors, and will be limited to the two years prior to the filing of Valero's complaint -- it may well not be entitled to the same reparations as shippers who filed in 1994. Accordingly, Valero must have its reparations claims adjudicated in the OR98-2 proceedings.

Valero's arguments do not convince us otherwise. Valero alleges that FERC's failure to provide reparations to Valero is directly contrary to the plain language and intent of the ICA. Under Section 8 of the ICA , injured shippers are provided a right of action for damages. *See* 49 U.S.C. app.

§ 8 (1988). But FERC's denial of reparations in Opinion No. 435-B is perfectly consistent with this provision. FERC did not hold in that order that Valero was not entitled to reparations. Rather, FERC deferred consideration of Valero's entitlement. Accordingly, FERC's decision is consistent with the ICA.

Valero argues that under *A.J. Phillips Co. v. Grand Trunk Western Ry. Co.*, 236 U.S. 662, 665, 35 S. Ct. 444, 59 L. Ed. 774 (1915), its party status in OR92-8 "is of no moment in awarding reparations." Pet. Joint Brief on Rate and Reparations Issues 28. While *A.J. Phillips* held that finding a rate unreasonable "inured to the benefit of every person that had been obliged to pay the unjust rate," *A.J. Phillips*, 236 U.S. at 665, it also recognized that a shipper's right to reparations turns on the timely filing of its complaint, and its rights are limited by that complaint. *Id.* at 665-66 ("But while every person who had paid the rate could take advantage of the finding that the advance was unreasonable, he was obliged to assert his claim within the time fixed by law"). Here, Valero -- which filed its complaint in 1997 -- is not entitled to the same reparations as the shippers who filed in 1994, since Valero's reparations will be determined upon a different test period and cost factors, and will be limited to the two-year period prior to the filing of Valero's complaint. *See* 49 U.S.C. app. § 16(3)(b) (1988). Thus, deferring consideration of Valero's claim is consistent with *A.J. Phillips Co.* While there is some commonality of issues between Valero's complaint proceeding and OR92-8, OR92-8 is not dispositive of Valero's reparations claims. Therefore Valero must await adjudication of its reparations claims in OR98-2.

4. *BP West Coast Products and Chevron*

Petitioners allege that because both BP WCP (formerly ARCO Products Co.) and Chevron (formerly Texaco Refining and Marketing, Inc.) were injured by SFPP's East Line rates and both jointly filed -- on January 14, 1994 -- a complaint, FERC violated the ICA by denying them reparations. FERC denied both of these entities damages from the East Line rates because they stated no claim regarding the East Line rates in their complaints. We again agree with FERC.

ARCO's and Texaco's complaint simply did not challenge the East Line rates. While their complaint referenced Tariff No. 15 along with other tariffs, which includes East Line rates, that reference was not specific to any rate, but alleged only that shippers shipped petroleum pursuant to one or more of those tariffs. That vague reference fails to state a cognizable complaint against the East Line rates, since otherwise the allegations solely concerned West Line rates. ARCO's and Texaco's complaint alleged, instead, that their "shipments basically originate in California and are transported by SFPP to Phoenix and Tucson." Transportation from California into Arizona occurs only on the West Line. Consistent with that allegation, the complaint addressed the grandfathering of the West Line rates, and sought reparations, at the least, from the date of the filing of their complaint, which is the standard for grandfathered rates. The affidavit submitted in support of the complaint concluded that "SFPP's rates on its West Line System exceed the rates that would result from an appropriate application of the Commission's ratemaking methodology by a significant amount." *SFPP, L.P.*, No. OR92-8-000, Affidavit of Marsha K. Palazzi 2 (Jan. 18, 1994). No mention of the East Line rates is made in the complaint or the supporting affidavit. Thus, the complaint was only applicable to the West Line rates. *See SFPP, L.P.*,

68 FERC at 61,582. Under these circumstances, the Commission reasonably interpreted the complaint to state a claim only with regard to the West Line rates, and BP WCP and Chevron were properly denied reparations for the East Line rates.

ARCO's October 2, 1992, intervention in OR92-8 does not change this result, *see* Rate Br. 32, since BP WCP's stated ground for intervention was its "direct interest" in the "new origin point and applicable rates at East Hynes." As the East Hynes station is on the West Line, this intervention likewise stated no claim with regard to the East Line rates.

5. *Chevron*

On September 23, 1992, Chevron filed a protest concerning SFPP's reversal of the flow of the "six-inch line" between Tucson and Phoenix, and SFPP's modification of its pro-rationing policy. On August 3, 1993, Chevron filed a complaint alleging that SFPP's East Line rates were unjust and unreasonable. Chevron demanded reparations "for the period beginning two years preceding the filing of the Complaint."

The Commission properly calculated Chevron's East Line rate reparations based on Chevron's 1993 complaint challenging those rates. *See supra* at 14 n.2. While Chevron argued that its 1993 complaint should relate back to its 1992 protest, the 1992 protest did not challenge the East Line rates, but rather only challenged flow reversal on one of SFPP's lines and its capacity allocation procedures.

Chevron now contends that its East Line reparations should be based upon the date of its 1992 protest because the Commission treated the protest as a complaint. The

Commission, held, however, that "the scope of the complaint proceeding shall be defined by the issues raised by El Paso and Chevron which caused these proceedings to be instituted." *SFPP, L.P.*, 63 FERC P 61,275, 62,769 (1993). Chevron's protest "complained against the reversal of one of SFPP's lines and its capacity allocation procedures, but did not complain against the East Line rates as such." Opinion No. 435-A, 91 FERC at 61,514 n.55. Because the protest did not complain about the East Line rates, the Commission properly found that the protest did not trigger reparations for the East Line rates, and dated Chevron's right to reparations from Chevron's August 3, 1993, East Line complaint. *SFPP, L.P.*, 97 FERC P 61,138 61,623-24 (2001) (citing *SFPP, L.P.*, 65 FERC P 61,028); *see also SFPP, L.P.*, 102 FERC P 61,073, 61,183-84 (2003).

The ALJ's determination that reparations demands could relate back to earlier-filed complaints does not aid Chevron. As the ALJ recognized, an amendment to a pleading may relate back when it arises out of the same transaction or occurrence set forth in the original pleading. Fed. R. Civ. P. 15(c)(2). Because the Commission found that Chevron's original protest did not concern the East Line rates, but rather only the practice of prorationing and reversal of the "six inch line," however, Chevron's claim for East Line rate reparations cannot relate back to that protest. The Commission reasonably determined that Chevron's 1993 complaint, which first stated a claim with regard to the justness and reasonableness of the East Line rates, was the proper basis for determining Chevron's right to reparations.

For the reasons given above, we affirm the decisions of the Commission in awarding reparations and deny the petitions for review in full to the extent they challenge FERC's reparations order.

CONCLUSION

In conclusion, we affirm the decisions of the Commission and deny the petitions except as follows: As regards the West Line rates, we grant the petition and remand with respect to the Commission's decisions that the Watson enhancement and turbine fuel rates are grandfathered under the EPAct. We also remand with respect to the Commission's determination that changes in tax allowance policy constitute "substantially changed circumstances" under the Act. As regards the East Line rates, we reverse the Commission's decision to rely on *Lakehead* insofar as it pertains to tax allowances, and thus grant the petition and remand the Commission's determination regarding the proper tax allowance for SFPP. We also grant the petition and remand for the Commission to determine and explain an appropriate allocation of the civil litigation costs between the West Line and East Line shippers. Finally, we grant the petition and remand for the Commission to address SFPP's request to recover its reconditioning costs.

APPENDIX D

UNITED STATES OF AMERICA
86 FERC ¶ 61,022
FEDERAL ENERGY REGULATORY COMMISSION

Docket Nos. OR92-8-000, OR93-5-000, OR94-3-000, OR94-4-000, OR95-5-000, OR95-34-000

Issued: January 13, 1999

SFPP, L.P.

Mobil Oil Corporation	)
	)
v.	)
	)
SFPP, L.P.	)
	)

Tosco Corporation	)
	)
v.	)
	)
SFPP, L.P.	)
	)

Opinion No. 435

Before Commissioners: James J. Hoecker, Chairman; Vicky A. Bailey, William L. Massey, Linda Breathitt, and Curt Hubert, Jr.

OPINION AND ORDER ON INITIAL DECISION

An initial decision issued in the captioned dockets that addressed the reasonableness of SFPP, L.P.'s (SFPP) rates for the transportation of various petroleum products from California and Texas to points in Arizona and New Mexico.[1] That decision concluded that the East Line rates between Texas and Arizona were not just and reasonable and ordered them to be modified and directed SFPP to make reparations accordingly. The initial decision also held that the complainants shipping on the West Line between California and Arizona had not met the jurisdictional standard for oil pipeline rate cases contained in the Energy Policy Act of 1992 (the EPAct),[2] and that therefore SFPP's West Line rates would continue to be deemed just and reasonable.

The Commission affirms the bulk of the initial decision while modifying and clarifying a number of rulings related to jurisdictional and cost-of-service issues. SFPP is directed to recalculate and refile its East Line rates to comply with this order. Any revised East Line rates developed pursuant to this order will be effective March 1, 1999. SFPP is directed to calculate the potential reparations, but the Commission will defer its decision on whether reparations must be made pending review of the compliance filing.

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[1] SFPP, L.P., 80 FERC ¶ 63,014 (1997).

[2] Public Law 102-486 (1992), enacted October 24, 1992, codified as 42 U.S.C. ¶ 7172 (1994)).

I. Background

A. Regulatory Framework

This is the first oil pipeline rate case to be decided under the provisions of the EPAct, enacted on October 24, 1992. The more important provisions of the EPAct included the "grandfathering" of certain rates that were not subject to protest, investigation, or complaint during 365 days prior to the enactment of the EPAct,[3] a requirement that such rates may be modified only if a complainant establishes substantially changed circumstances,[4] and modified provisions for reparations for complaints meeting the jurisdictional standards of the EPAct.[5]

After this proceeding began, the Commission initiated rulemaking proceedings to modify its regulations governing oil pipeline rate filings and complaints, including regulations governing the type of information required to justify such filings. This case also involves oil pipeline rate issues such as the starting rate base, its capitalization and amortization, the allocation of costs among different regions or zones, and cost-of-service issues such as the cost of capital, litigation, repair, and retirement expenses, and tax allowances.

B. SFPP and its Operations

SFPP owns a pipeline system that transports refined petroleum products in six Western and Southwestern states:

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[3] Section 1803(a) of the EPAct.

[4] Section 1803(b) of the EPAct.

[5] *Id.*

Texas, New Mexico, Arizona, California, Nevada, and Oregon.[6] This proceeding involves SFPP's interstate rates, practices, and terms and conditions of service on its "South System," which consists of pipe and other facilities used to transport refined petroleum products into Arizona from El Paso, Texas (the "East Line") and from the Los Angeles, California area (the "West Line").[7] A map of the South System is attached as Appendix A.

The West Line consists of a 24-inch pipeline from Watson Station to Norwalk, California, a combination 20-inch and 24-inch pipeline and a 16-inch pipeline from Norwalk to Colton, California, a 20-inch pipeline and a 12-inch pipeline from Colton to Phoenix, Arizona, and a 6-inch pipeline from Phoenix to Tucson, Arizona. The East Line consists of parallel 8-inch and 12-inch pipelines between El Paso and Tucson and one pipeline (at various points 8- or 12-inches) between Tucson and Phoenix. SFPP also operates an enhancement facility at its Watson Station, in California. The Watson Station enhancement system, installed in 1994 after negotiations with its shippers, consists of vapor collection piping connected to tanks and related vapor collection facilities that allow SFPP to operate its tanks at a higher pressure than that previously used on it systems.[8]

SFPP, whose rates are at issue in this proceeding, is a limited partnership that was organized on December 19, 1988,

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[6] Exh. 142 at p. 9.

[7] Exh. 144 at p. 3.

[8] *Id.* at pp. 12, 14.

under Delaware law.[9] SFPP succeeded to the assets of its predecessor company, Southern Pacific Pipe Lines, Inc. ("SPPL"), which was the original owner and operator of the South System, and was owned by the Santa Fe Pacific Corp.[10] The tariff rates for movements over the East and West Lines into Phoenix were equal from the pipeline's inception in 1956 until 1985.[11] In 1985 SFPP's predecessor filed equalized tariff increases to reflect capital expenditures undertaken on the West Line to increase capacity into Phoenix. This filing was protested by certain East Line shippers, including Navajo Refining Company ("Navajo"), which objected to paying any rate increase attributable to capital improvements on the West Line.[12]

The Commission terminated the 1985 rate proceeding by approving two settlement agreements reached by the pipeline and the protesting shippers. The first settlement, filed on July 6, 1988, was approved on November 17, 1988,[13] and the second, dealing only with Navajo's issues, was filed on January 30, 1989, and was approved on October 19, 1989.[14]

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[9] See 80 FERC at ¶ 65,118 and Exh. 142 at p. 5 for the details of SFPP's relation to its parent and affiliated companies.

[10] Exh. 142 at p. 8; Tr. 8125.

[11] Exh. 142 at p. 11; *see also* Tr. 8128-29.

[12] Exh. 142 at p. 12; Tr. 8129.

[13] *See Southern Pacific Pipe Lines, Inc.*, 45 FERC ¶ 61,242 (1988).

[14] *See Southern Pacific Pipe Lines Partnership, L.P.*, 49 FERC ¶ 61,081 (1989).

Both settlements rolled back the South System rate increases from those filed in 1985, effective November 24, 1988, provided for refunds based on those lower rates through the settlement dates, and for the first time established a rate differential for movements into Phoenix on the East and West Lines. The rates challenged in this proceeding are those established by the two settlements.[15]

Under these settlements, SFPP completed several expansion projects on both its East and West Lines during the late 1980s and early 1990s and increased its rates as permitted under the settlement agreements.[16] Two West Line expansion projects increased capacity to 173,000 barrels per day into Phoenix from Los Angeles at a cost of about $140 million. As part of those expansion projects SFPP reinstituted West Line service from Phoenix to Tucson over its 6-inch line.[17] The West Line expansion project was completed in January 1989, and the related rates were increased at that time.[18]

The East Line expansion project was undertaken in two phases. In Phase I, completed in February 1992, SFPP made facility modifications at Tucson and it increased pumping capacity at a cost of approximately $4 million. In Phase II, SFPP replaced forty miles of 8-inch pipe between Tucson and Phoenix with 12-inch pipe and constructed more breakout tanks at Tucson at a cost of approximately $20 million. The East Line expansion project increased capacity between El

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[15] Exh. 142 at pp. 13-14.

[16] *Id.*; Tr. 8131; see Exh. 147 at pp. 6-14.

[17] Exh. 147 at pp. 7-9; See also Exh. 863 at 45.

[18] *See* 49 FERC ¶ 61,081 (1989).

Paso and Tucson to 95,000 barrels per day, and between Tucson and Phoenix to 55,000 barrels per day.[19]

During Phase II of the East Line expansion project SFPP reversed and then re-reversed its 6-inch line between Tucson and Phoenix. The 6-inch line had been in West Line service from Phoenix to Tucson since completion of the West Line expansion in 1989, but was under-used during 1990 and early 1991. To serve its customers during Phase II of the East Line expansion project, SFPP reversed the 6-inch line in August 1991 to operate in East Line service from Tucson to Phoenix.[20] SFPP returned the 6-inch pipeline to West Line service upon completion of Phase II of the East Line expansion at the end of August 1992.[21] At that time, SFPP began to carrying out the terms of an agreement it had made with ARCO Products Company ("ARCO"). The Reversal Agreement obligated SFPP to dedicate the 6-inch line to West Line service for five years, with possible renewals for three additional five-year periods. ARCO agreed to ship an annual volume of 1.825 million barrels of product from Phoenix to Tucson (based on a 5,000 barrels per day commitment) or to pay SFPP damages in the form of equivalent revenues.[22] ARCO did not renew the Reversal Agreement when it expired in 1997.

The litigation involved here was engendered by disputes between SFPP and its shippers, and among its shippers,

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[19] Exh. 147 at p. 10.

[20] Exh. 147 at pp. 9-10.

[21] *Id.* at p. 11.

[22] *Id.* at pp. 15-17; see also Exh. 119 (ARCO Reversal Agreement).

regarding the allocation of costs among the various expansions and services, the overall level of SFPP's rates, the jurisdictional status of the Watson Station enhancement facilities, and whether the details of the ARCO Reversal Agreement and the obligation of SFPP's to publish its prorationing policy in its tariff.

C. Procedural History

This proceeding was initiated on September 4, 1992 when El Paso Refinery, L.P. ("EPR") filed a pleading styled "Protest or, Alternatively, Complaint" with the Commission.[23] EPR alleged, among other things, that SFPP's proration policy[24] and the re-reversal of the direction of flow of the 6-inch line between Phoenix and Tucson adversely affected its business, and that SFPP's existing East Line rates should be reduced.[25] On September 29, 1992, the

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[23] No shipper protested SFPP's FERC Tariff Nos. 15, 16 and 17, filed on July 31, 1992, which added a new West Line origin point at East Hynes, California.

[24] The term "proration" refers to the allocation of pipeline capacity among shippers during periods when the aggregate volume of petroleum products which shippers nominate for transportation exceed the capacity of the pipeline.

[25] This complaint was filed before October 24, 1992, and therefore is not subject to the grandfathering provisions of the EPAct. The Commission granted Refinery Holding Company, L.P. ("RHC") party status as the successor in interest to EPR following EPR's bankruptcy. SFPP, L.P., 65 FERC ¶ 61,028 (1993), *reh'g denied*, 66 FERC ¶ 61,210 (1994).

Commission's Oil Pipeline Board ("Board") suspended SFPP's tariffs for one day and set them for investigation.[26]

On December 31, 1992, SFPP filed FERC Tariff No. 18 to provide its West Line shippers with the service of transporting turbine (or jet) fuel to Tucson. EPR and Chevron USA Products Co. ("Chevron") protested Tariff No. 18, arguing that it raised many of the same issues that were pending in proceeding begun on September 29, 1992, and that the rate for the turbine fuel contained in Tariff 18[27] was unjust and unreasonable. On January 29, 1993, the Board suspended Tariff No. 18 for one day subject to refunds, instituted an investigation under Section 15(7) of the ICA, and consolidated the cases.[28]

SFPP filed exceptions to both of the Board's September 29, 1992, and January 29, 1993 orders. On April 2, 1993, the Commission vacated the original suspension orders and the refund obligations,[29] holding that the case should go forward as a complaint proceeding limited to the issues raised by EPR, Chevron and the intervenors. The Commission concluded that allegations about the unlawfulness of SFPP's past and existing practices with respect to flow reversal, prorationing, and current rates, should be adjudicated under section 13(1). The April 2, 1993 order also placed the burden of proof on the complainants to prove the challenged rates

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[26] SFPP, L.P., 60 FERC ¶ 62,252 (1992).

[27] The rate for the turbine fuel was the same rate previously filed in the predecessor Tariff Nos. 15, 16, and 17.

[28] SFPP, L.P., 62 FERC ¶ 62,060 (1993).

[29] SFPP, L.P., 63 FERC ¶ 61,014 (1993).

were not just and reasonable since SFPP had not proposed to modify those rates.[30]

Chevron and Navajo filed requests for rehearing. The Commission issued two Orders on Rehearing in response. In the first, issued June 18, 1993, the Commission reaffirmed its ruling vacating the Board's suspension order and imposition of refund obligations. The Commission reiterated its conclusion that the protests addressed in the Commission's September 29, 1992 and January 29, 1993 orders were in the nature of complaints, and that the burden of proof was on the complainants. The Commission terminated the suspension dockets and stated that the proceedings would proceed in the complaint docket, OR92-8-000.[31] On August 3, 1993, Chevron filed its complaint against the West Line rates.

On October 5, 1993, the Commission issued a further rehearing order in response to the rehearing requests filed by EPR, Chevron, Navajo and SFPP. The Commission first reiterated its prior conclusion that none of the protests had challenged anything that SFPP had proposed to change in the filings addressed by the September 29, 1992 and January 29, 1993 orders.[32] With respect to grandfathering of SFPP's

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[30] *Id.* at 61,124-25. On June 14, 1993, EPR sought to amend its complaint by adding claims for reparations. Over SFPP's objection, on September 10, 1993, the presiding administrative law judge ruled that EPR's complaint would be amended back to September 4, 1992, and that EPR could seek reparations for the period beginning two years prior to that date. This point is now moot as to EPR.

[31] SFPP, L.P., 63 FERC ¶ 61,275 at 62,789 (1993).

[32] SFPP, L.P., 65 FERC ¶ 61,028 at 61,376 (1993).

rates, the Commission agreed with SFPP that nothing in the initial protests filed by EPR and Chevron challenged SFPP's West Line rates, and therefore found those rates had been deemed just and reasonable under Section 1803(a) of the EPAct, pending resolution of the complaint.[33] The Commission therefore held that Chevron must establish substantially changed circumstances under Section 1803(b) of the EPAct as a condition for litigating whether SFPP's West Line rates are unlawful as it had challenged rates that had not previously been in effect. The order therefore affirmed the dismissal of Chevron's protest of Tariff No. 18, holding that the relevant protest could not apply to rates that were not modified when the tariff was filed.[34] The October 5 Order also affirmed SFPP's right to present market-based evidence while noting that at that point SFPP had no intention to do so.

Additional complaints were filed on December 22, 1993, by Navajo (challenging SFPP's East and West Line rates) and on January 14, 1994, jointly by ARCO Products Co. and Texaco Refining and Marketing Inc., both of whom challenged SFPP's West Line rates. In its answers SFPP acknowledged that Navajo need not meet the requirement of establishing a substantial change in the economic circumstances because Navajo was contractually barred from filing a compliant during the 365 day period proceeding the October 24, 1992 effective date of the EPAct.[35] SFPP

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[33] *Id.* at ¶ 61,378.

[34] *Id.* On November 4, 1993, Chevron filed a third petition for rehearing, this time challenging the Commission's October 5 Order. The Commission denied that request on February 17, 1994. SFPP, L.P., 66 FERC § 61,210 (1994).

[35] See Section 1803(b)(2) of the EPAct.

asserted, however, that other parties could not "piggy-back" on Navajo's complaint and challenge the West Line rates without establishing substantially changed circumstances. On April 20, 1994, the Commission held that the filing of Navajo's complaint removed the grandfathering protection from SFPP's West Line rates and that ARCO, Texaco and Chevron therefore need not establish substantially changed circumstances.[36] However, in response to SFPP's request for rehearing of that ruling, the Commission reversed its April 20 Order concluding that the plain meaning of the language of section 1803 required Chevron and ARCO/Texaco to meet the substantially changed circumstances standard.[37] Petitions for rehearing of that order were denied on September 16, 1994.[38]

Further complaints were filed against Tariff Nos. 15, 16, 17, and 18 by Mobil on August 3, 1995, and by Tosco on August 7, 1995, and were consolidated with the instant proceeding.[39] Since that date several additional complaints

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[36] SFPP, L.P., 67 FERC ¶ 61,089, at p. 61,255 (1994). The Commission further held that any reparations with respect to SFPP's West Line rates could be prospective only, starting from the date of the filing of each complaint. *Id.*

[37] SFPP, L.P., 68 FERC SFPP, L.P., 68 FERC ¶ 61,105, at p. 61,581 (1994).

[38] SFPP, L.P., 68 FERC ¶ 61,306 (1994).

[39] These complaints were filed after SFPP filed its responsive testimony, and therefore Mobil and Tosco were required to accept the record as it stood when they filed their complaints. *Mobil Oil Corp. v. SFPP, L.P.*, 73 FERC ¶ 61,032 (1995); *Tosco Corp. v. SFPP, L.P.*, 74 FERC ¶ 61,056 (1996).

have been filed against SFPP.[40] In each case the Commission held the complaints in abeyance pending the outcome of the decision in this proceeding. Thus, the instant order only addresses the consolidated complaints that were filed through August 7, 1995.

The hearing began in 1993, and pursuant to an ALJ order, SFPP filed a Cost and Revenue Study in February 1994, setting forth unadjusted results for 1993. The complainants filed written direct testimony in June of 1994 and the Commission Staff did so in August. SFPP's responsive testimony was filed in April 1995, and all rebuttal testimony in August 1995. SFPP moved to strike those portions of the Staff's and complainants' testimony that included updated test year information, or alternatively, for leave to file surrebuttal testimony responding to the parties' testimony. The ALJ granted SFPP's alternative motion and permitted SFPP to file surrebuttal testimony, and allowed the other parties sur-surrebuttal testimony. The hearing on commenced on April 9, 1996, and lasted until July 19. Briefing was competed November 16, 1996.

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[40] The complaints that have not been consolidated with the instant proceedings are: Docket Nos. OR96-2-000, OR96-10-000 (75 FERC ¶ 61,292 (1996)), and OR96-17-000 (77 FERC ¶ 61,033 (1996)), as consolidated; Docket Nos. OR96-15-000 (77 FERC ¶ 61,191 (1997)) and OR97-2-000 (78 FERC ¶ 61, 61,047 (1996)) held in abeyance pending the decision in OR92-8-000, *et al.*; and Docket Nos. OR98-1-000, OR98-2-000 (82 FERC ¶ 61,043 (1998), and OR98-13-000 (84 FERC ¶ 61,139 (1998), as consolidated, and held in abeyance pending the decision in OR92-8-000, *et al.* Any party that made a timely filing to intervene and was not formally listed in the Commission's orders in these proceeding will be admitted in the separate order addressing the future of these proceedings.

During the hearing, SFPP and EPR reached an agreement to settle all issues raised in EPR's complaint, pleadings and testimony filed in this proceeding, provided that the agreement would not prejudice the rights of other parties.[41] After the conclusion of the hearing, Navajo withdrew its complaint against SFPP's West Line rates, subject to the condition that Navajo's withdrawal would not prejudice the rights of other parties.[42] Navajo remained as a complainant against SFPP's East Line rates. The initial decision issued on September 25, 1997. Six parties filed briefs on exceptions on December 5, and briefs opposing exceptions on January 23, 1998.

D. The Initial Decision

The 100 page initial decision addressed 38 major issues the ALJ consolidated into thirteen sections, each organized around several related issues. The details of the ALJ rulings and the related exceptions filed are discussed below.

II. Discussion

This discussion follows a somewhat different organizational structure than the initial decision. The first section addresses all basic jurisdictional issues establishing whether the Commission will entertain the parties' arguments, the second addresses the rate design issues that determine how costs are to be allocated among the different sections of SFPP's pipeline, the third section addresses various operating

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[41] SFPP, L.P., 76 FERC ¶ 63,018 (1996).

[42] See SFPP, L.P., 80 FERC ¶ 63,014 (1997) and SFPP, L.P., 80 FERC ¶ 61,088 (1997).

and capital issues, the fourth addresses the scope of reparations, and the fifth addresses the publication of prorationing policies. A sixth addresses the content of the compliance filing to this order and an overview of procedures pertinent to the remaining complaint proceedings involving SFPP.

A. Jurisdictional and Related Procedural Issues

The EPAct provides that, with one exception not relevant here, all rates in effect on the date of the Act are deemed just and reasonable, and are not subject to a maximum rate challenge unless the rate was subject to protest, investigation, or complaint in the 365 day period before the Act was effective.[43] Such rates may be challenged only if the complainant "presents evidence which establishes that there has been a substantial change after the enactment of [the Act] in the economic circumstances of the pipeline that are the basis for the rate" or a substantial change "in the nature of the services which were the basis for the rate."[44] Therefore, a threshold issue is what rates, if any, are grandfathered under the provisions of the Act, and if they are, whether the complainants have established substantially changed circumstances[45] as required by the statute.

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[43] Section 1803(a)(1) of the EPAct.

[44] Section 1803(b)(1)(a)and(b) of the EPAct.

[45] The phrase "substantially changed circumstances" is used in this order as an abbreviation of the statutory threshold.

1. The "Grandfathering" of Rates.

A number of the consolidated dockets at issue here raise the question of whether they are barred by the grandfathering provisions of the EPAct. In the initial phases of this proceeding, the Commission determined that Navajo did not have to establish substantially changed circumstances in order to challenge either the East or the West Line rates.[46] However, the Commission ultimately determined on rehearing of a series of complaints filed by ARCO, Chevron, and Texaco against SFPP's West Line rates, that those rates were generally subject to the grandfathering provisions of the EPAct, and that these parties were required to establish substantially changed circumstances in order to challenge the West Line rates at issue here. Addressing these complaints, the ALJ held that they failed to meet the statutory standards and that therefore ARCO's, Chevron's and Texaco's complaints were barred under the EPAct. No party argues here that SFPP's East Line rates are grandfathered, and that Navajo and Chevron, the remaining complainants complaints against the East Line rates, are required to establish substantially changed circumstances with regard to those rates.[47]

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[46] SFPP, L.P., 68 FERC ¶ 61,105, at p. 61,581 (1994), order on *reh'g*, SFPP, L.P., 68 FERC ¶ 61,306 (1994).

[47] Navajo was party to a settlement that barred challenges to the East and West Line rates during the one year period proceeding the enactment of the EPAct. As such it was not barred from pursuing a complaint once the applicable settlement expired. Navajo subsequently withdrew its complaint against the West Line rates.

The West Line Shippers[48] filed exceptions to this determination on two grounds: first that the ALJ improperly held that all West Line Rates were grandfathered as to complainants other than Navajo; and second, that the ALJ had improperly ruled on the issue of substantially changed circumstances.[49] The West Line Shippers first assert that the rates from East Hynes, California, to Arizona, are not grandfathered because the East Hynes point did not exist prior to the passage of the EPAct, and SFPP has effectively admitted that rates from East Hynes are not grandfathered. West Line Shippers also assert that the balance of West Line rates are not grandfathered because (1) the rates were protested prior to the enactment of the EPAct, (2) SFPP admitted in its 1992 SEC Form 10-K that they were challenged, (3) the Oil Pipeline Board had suspended the West Line rates in an earlier order, and (4) Navajo's filing of a complaint under section 1803(b)(2) of the EPAct removed the need of the West Line Shippers to establish substantially changed circumstances. They assert that since the Commission's reversal of the Oil Pipeline Board occurred after the rates had been suspended, they could not have reasonably been expected to know that an additional challenge was required and to have filed a complaint in a timely fashion. West Line Shippers also argue that the Commission has expressly held that two sets of SFPP's West lines rates are not grandfathered, SFPP's rates from East Hynes and SFPP's rates under its Tariff No. 18 for turbine fuel from California origins to Tucson, Arizona.

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[48] The "West Line Shippers" refers to ARCO Products Company, Mobil Oil Company, Texaco Refining and Marketing, Inc., and Tosco Refining Company.

[49] The substantially changed circumstances issue is discussed in the next section of this order.

SFPP and Navajo oppose these exceptions. They assert that the Commission has previously ruled on the arguments relating to the protests filed by ARCO, Texaco, and Chevron prior to the enactment of the EPAct, and that the Commission concluded that those protests did not challenge the overall level of SFPP's existing West Line rates. They also assert that the Commission has specifically ruled that the West Line Shippers may not "piggy-back" on Navajo's complaint.[50] SFPP argues that the prior Oil Pipeline Board action could not bind the Commission, that it did not admit that the West Line rates had been challenged, and that it alluded to this litigation in its 10-K only because the Commission had not ruled in its review of the Board's suspension action at the time SFPP's 1992 10-K was filed.

SFPP and Navajo argue that, under *Santee Distribution Company v. Dixie Pipeline Co.*,[51] changes to a tariff, as opposed to changes to rates, do not affect the grandfathering status of any rates already stated in the tariff that are not modified when the tariff is filed. SFPP further asserts that the filings it made in July of 1992 simply added East Hynes as a Los Angeles origin station to an existing rate cluster and that therefore there was no change in the rates from Los Angeles to Arizona. Navajo asserts that the same rationale applies to a new service, such as transportation of turbine fuel from Los Angeles to Arizona. However, SFPP concedes that the Commission has previously held in a September 1994 rehearing order that the Tariff No. 18 rate, which added the

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[50] SFPP, L.P., 68 FERC ¶ 61,105 at 61,581-82 (1984).

[51] 71 FERC ¶ 61,205, at 61,753 (1995), *aff'd on reh'g*, 75 FERC ¶ 61,254 (1996).

turbine fuel in 1993, was not subject to the grandfathering provisions of the EPAct.[52]

The Commission concludes that the only grandfathering issues that require further analysis at this point are those related to the revised Tariff No. 18 that SFPP filed on December 31, 1992. The Commission finds that the addition of the East Hynes station is subject to the grandfathering provisions of the EPAct because this filing did not involve a change to a rate or service SFPP was providing at the time the EPAct was enacted. As SFPP states, that tariff change only added another tap within an existing rate cluster for transportation services provided for a group of commodities from that rate cluster to points in Arizona. No rate from Los Angeles to Arizona was changed, and there was no change in the products transported or the services provided. Since neither the rates nor the services provided were changed, the Commission concludes that the East Hynes station is part of a rate that was not subject to protest, suspension, or investigation in the 365 days proceeding enactment of the EPAct.

However, the Commission affirms its earlier conclusion that Tariff No. 18, to the extent it added turbine fuel to SFPP services, is not subject to the grandfathering provisions of the EPAct. When it filed Tariff No. 18, SFPP began to transport a new commodity, and as such to provide a new service for a specific commodity that had not heretofore been listed in its tariff, i.e., the transportation of turbine fuel. SFPP may have applied an existing rate to the new commodity, but adding that commodity instituted a new service, and was not a change in

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[52] See 68 FERC ¶ 61,306, at 62,263 n.12.

the nature of the service that was the basis for the rates.[53] Thus, even though at the time there were a number of services provided under in Tariff No. 18, the grandfathering provisions of the EPAct do not apply, and the complaining parties do not need to establish substantially changed circumstances to challenge the rate applicable to turbine fuel under Tariff No. 18.

Regarding the other rates complained against, the West Line shippers assert, that they could not have anticipated that the Commission would reverse an Oil Pipeline Board order that has suspended the tariffs with which they were concerned, and that therefore the Board's suspension of Tariff Nos. 15, 16, and 17 on September 29, 1992 should remove the statutory bar. As the Commission explained in its June 18 and October 5, 1993 orders, the matters the West Line Shippers protested did not involve any changes that SFPP made when it filed Tariff Nos. 15, 16, and 17. The fact that the Oil Pipeline Board initially suspended certain tariffs does not change the basic fact that the Commission's power to investigate (and suspend) a pipeline filing, either under the ICA and the NGA, only attaches to those portions of a tariff that the carrier proposes to change.[54] This is true even though the custom in the oil pipeline industry is to file a new tariff rather than to file supplements or changes to existing pages.

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[53] See Section 1803(b)(1)(B) of the EPAct.

[54] *See Western Resources v. FERC*, 9 F.3rd 1568, 1574, 1578 (D.C. Cir.)(1993); *East Tennessee Natural Gas Company*, 863 F.2d 932, 937 (D.C. Cir. 1988); *See Robin v. FERC*, 795 F.2d 182, 183 (D.C. Cir. 1986). See also, Iroquois Gas Transmission Company, 84 FERC ¶ 61,086 at 61,458 (1988)(Iroquois).

Given that only carrier proposed rates are subject to suspension, the parties should have taken greater care to frame their pleadings accordingly. Thus, if the West Line Shippers were concerned about SFPP's West Line rates in September of 1992, they should have filed a complaint against those rates before the EPAct became effective. The remaining arguments on the protests and complaints filed before the enactment of the EPAct on October 24, 1992, were addressed in the Commission's prior orders and there is no need to address them further here.

2. Substantially changed circumstances.

The EPAct requires, among other things, that any party challenging a grandfathered rate must provide evidence to the Commission of a substantial change in the economic circumstances of the pipeline which were the basis for the rate[55] before the Commission may determine the reasonableness of the challenged rate. In the instant case, the issue applies only to the West Line rates that have been challenged by the West Line Shippers. The ALJ interpreted the substantially changed circumstances standard as requiring proof of change that exceeded a material change in the economic circumstances that were the basis for the existing rate(s). Applying this standard, the ALJ concluded that the West Line Shippers had failed to establish substantially changed circumstances and that, with the exception of Navajo's complaint and the new service included in Tariff No. 18, SFPP's West Line rates must be deemed to be just and reasonable.

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[55] Section 1803(b)(1)(A).

He therefore rejected the arguments of Chevron and the West Line Shippers that changes in five factors warranted a finding of substantially changed circumstances. These factors were increased throughput on the West Line between California and Arizona, increased demand for turbine fuel reflected in SFPP's Tariff No. 18, changes in environmental regulations in California, the impact of the Commission's *Lakehead* decision[56] on SFPP tax allowances, and the filing of the complaints themselves. Chevron and the West Line Shippers assert that the ALJ erred in rejecting the factors. SFPP and Navajo state that none of these factors are appropriate and support that ALJ's ruling that there are no substantially changed circumstances. The Commission Staff did not address in detail the arguments on whether "substantially changed circumstances" exist here, but suggested that the Commission provide some guidance on the matter. In affirming the ALJ, the Commission will address the statute, the arguments on each of the factors addressed by the ALJ, and some related procedural matters.

a. The Statutory Standard

Section 1803(b)(1) of the EPAct states that a grandfathered rate may be challenged only if the complainant

> presents evidence to the Commission which establishes that a substantial change has occurred after the date of the enactment of [the Act]:

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[56] Lakehead Pipe Line Company, L.P., 71 FERC ¶ 61,338 (1995), *reh'g denied*, 75 FERC ¶ 61,181 (1996). (Lakehead).

(A) in the economic circumstances of the oil pipeline which were the basis for the rate; or

(B) in the nature of the services provided that were the basis for the rate; or

(C) the person filing the complaint was under a contractual prohibition against filing a complaint which was in effect on the date of the enactment of the EPAct, and had been in effect prior to January 1, 1991, provided the complaint is brought within 30 days after the contractual prohibition expires.[57]

The provision at issue here is subsection (b)(1)(A) addressing "a substantial change in the economic circumstances of the oil pipeline which were the basis for the rate."[58]

As noted, the ALJ held that a substantial change exceeds the concept of a material change and should be considered a rigorous standard for filing a complaint.[59] On exceptions, the West Line Shippers argue that the ALJ erred in failing to conclude that a "substantial change" is the same as a material change, and that therefore the standard he adopted was unduly rigorous. They assert that in other Federal legislation the word "substantial" has been construed to be equivalent to "material",[60] and that "material", "significant" and

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[57] Section 1803(b)(1) of the EPAct.

[58] Section 1803(b)(1)(A).

[59] 80 FERC at 65,193.

[60] West Line Shippers Brief on Exceptions at 39, citing *Rhode Island Higher Educational Association v. U.S. Department of*

"*substantial*" are considered to be similar terms. They also assert that the ALJ erred in failing to find that evidence occurring after the complaint was filed to establish substantially changed circumstances.

In reply, Navajo asserts that the more stringent standard is appropriate and that the complainants have not established a substantial change in the economic circumstances that are the basis for the rates challenged here. Navajo argues that the rates at issue here are based on the assumptions contained in SFPP's 1988 and 1989 Settlements and it is changes in the basis to those rates that must be demonstrated. SFPP similarly asserts that "substantial" is a much stricter term than "material", and that the ALJ's decision was correct in that regard. SFPP also argues that it operates its South System as a whole and that the issue of whether there are substantially changed circumstances applies to that system, not the East and West Lines separately.

The Commission finds that the ALJ was correct in concluding that a "substantial" change is more rigorous test than a "material" change. An example based on the plain language of the statute illustrate the interpretation the Commission is adopting here. As a matter of common usage the words "material' and "substantial" usually have a different connotations, even when they appear to be used as synonyms. For example, if one group of voters delivers an election by a one half of one percent margin, their participation was clearly material, and in fact, decisive. But few would conclude as a matter of common usage that such a narrow election margin was substantial. This example suggests that the term "material" is qualitative and goes to the

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Energy, 929 F.2d 844 (1st. Cir. 1991).

relative importance or weight of a matter, or indicates its relevance, not necessarily its quantity or size.[61] The dictionary definitions reviewed in footnote 61 indicate that a change that is "substantial" is likely to be "material" but that the obverse is not necessarily true. For example, a relatively small change in the rate of return the Commission allows a pipeline may have a material impact on the expectations of the pipeline's owners without the overall rate impact being substantial. The essential difference between the two terms is one of importance in the sense of logic or relevance (material), and importance in terms of relative degree or size (substantial). In the context of ratemaking "substantial" more appropriately reflects a considerable difference in amount or degree since ratemaking is essentially a quantitative discipline based on numerical formulas and relationships, for example, the pipeline obtained a substantial return on equity, or the shippers received a substantial rate reduction from the settlement.

This difference between importance or weight as a matter of logic or relevance (material) and importance as a matter of scope or degree (substantial) is also reflected in securities regulation. The SEC defines its disclosure requirements in terms of "materiality." The SEC defines such information as that which would influence a well informed, reasonable person whether or not to make an investment. The term "materiality" is not necessarily quantified by a given percentage or dollar amount; it need only be enough to sway

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[61] See the New Shorter Oxford Dictionary (Clarendon Press - Oxford 1998 Ed.), defining "material" at 1714 and "substantial" at 3124.

See also The American Heritage Dictionary (Houghton Mifflin Company (1976) defining "material" at 806 and at 1284.

the investor's decision.[62] This could mean, for example, the fact that negotiations are underway even though they have not been completed,[63] or that a portion of the company's debt is held by one of the officers, factors which affect risk but which may not be directly quantifiable.[64] Moreover, where the definition of material is used in a quantified manner, it is often a relatively low threshold. For example, accountants certify audits on the basis of material facts, which normally implies a change of 10 percent, the definition of "material" used in the Commission's oil pipeline accounting regulations for determining whether a change must be disclosed.[65]

Moreover, the legislative history of the EPAct, while very limited, indicates that the word "substantial" was substituted for the word "material" during the drafting phase, and as such implies the two words reflect a different standard.[66] The substitution would not have been necessary if the two words were to be considered identical in import, the interpretation of other federal statutes, or other case law or dictionary definitions stating that they are synonymous notwithstanding. The Commission concludes that Congress would not have used the word "substantial" rather than the word "material" if the conventional accounting threshold of ten percent, or

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[62] See Loss, Louis, Securities Regulation, Little Brown and Company, 1991, at 305-06 and 719-21.

[63] *Id.* at 720, n. 88.

[64] Rappaport, Louis H., SEC Accounting Practice and Procedure, The Ronald Press, 3rd. Ed. 1972 at 16-14.

[65] See 18 C.F.R. Part 282, Section 1-6(f).

[66] 80 FERC at 65,193, n.763, citing Exh. 192 at 3.

another relatively low quantity, was meant to be the test for establishing substantially changed circumstances in the economic basis of the pipeline.

For these reasons, the higher burden adopted by the ALJ is appropriate. Moreover, he was correct that the justness and reasonableness of the rate is not relevant to making a determination of whether the complainant has established that here are substantially changed circumstances. As the Commission recognized in *Santee,*[67] it is possible that a challenged rate might not be just and reasonable if the Commission were to examine it without the presence of the jurisdictional threshold, but that the statute would bar such an examination. Thus, even if the level of a challenged rate might be reduced if the statutory threshold were met, reasonableness may not be determined unless the complainant first establishes that there has been a substantial change in the economic circumstances that are the basis for the rate.

The parties also debate whether a complainant must establish that there has been a substantial change to every rate design element that may be the economic basis for the rate in order to meet the substantially changed circumstances standard. The Commission finds that this is not the case; the statute states that a complainant must present evidence and establish that there has been a substantial change in the economic circumstances of the pipeline that are the basis of the rate.[68] Such a change could be established by one or a number of rate elements, thereby justifying an evaluation of

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[67] *Santee Distrib. Co., v. Dixie Pipeline Co.*, 71 FERC ¶ 61,254 (1996)(*Santee*).

[68] Section 1803(b)(1)(A) of the EPAct.

whether the rate is just and reasonable. However, as part of establishing that there has been a substantial change in the economic basis for the rate, a complainant should explain why the Commission should conclude that the challenged rate may reasonably be expected to be found to be unjust and unreasonable in any subsequent investigation.

On exceptions, the complainants assert that even these modest requirements could result in an undue burden. However, the number of rate elements that significantly affect the economic basis for most rates is relatively small. The basic ones are volumes, asset base, operating, and perhaps, capital costs. These in turn are most likely to influence the company's revenue requirements and return. Thus, a complainant must establish substantial change to one of these more important elements that are the basis for the rate and explain why this change is likely to have rendered the existing rate unjust and unreasonable. Basic information on these elements is not beyond the reach of the most parties given the materials available in FERC Form No. 6 or SEC Reports, and as in this case, may be supplemented by discovery.

The Commission also concludes that Navajo is correct that the economic basis for the rates at issue here is not the twelve month period before the enactment of the EPAct, but the 1988 West Line settlement rates, as increased to reflect the increased capacity SFPP constructed pursuant to those settlements. The West Line expansion was completed in 1989 and, as the ALJ noted, it is the West Line rates that are challenged here. Thus, any changed circumstances must be measured against the economic assumptions embodied in the rates filed after the expansion was completed to determine whether the change is substantial.

For the same reason, SFPP's argument that the issue of substantially changed circumstances applies to the South System as a whole, not its West and East segments, fails. For whatever reason, SFPP designed its current South System rate structure using two different sets of rates that reflect the economic basis of two different services, which serve two competing groups of shippers for whom the rate differentials are significant. Even if shippers use both the East and West Lines at different times, or simultaneously, this does not change the fact that the economic characteristics of the services and the shipments involved are different. Moreover, the challenge must be to the economic circumstances that are the basis for the rate challenged. In this case these are the West Line rates, not a broader, geographically defined system utilizing an undifferentiated rate structure as SFPP argues here. Since there are no rates for the South System as a whole, the statutory standard can only be applied to the rates for SFPP's separate East and West Lines. The ALJ's analysis was correct.

b. The Specific Allegations of Change Circumstances.

(1) Increased Throughput

The ALJ determined that the West Line Shippers and Chevron did not establish that increases in volumes on the West Line System after October 1992 resulted in substantially changed circumstances. Both parties assert this was error.

The Commission affirms the ALJ. All the complainants measure the increase in volumes on the SFPP West Lines using a statistical base consisting of the 12 months prior to the effective date of the EPAct, October 24, 1992. They defined base volumes for that period, and then compare those to volumes for an approximately two and one-half year period

thereafter. The estimated increases in volumes range of 27 to 36 percent depending on the base and the date of the last measurement.[69] However, as has been discussed, the base point for measuring whether a change is substantial is not the twelve months proceeding the effective date of the EPAct, but the economic circumstances the are the basis for the rate. In this case, these are the economic bases for the rates to implement SFPP's West Line expansion, which became effective in 1989.[70] Thus, any changes must be measured from that point in time, and then only using evidence of changes in the economic basis for the rate that occurred after the effective date of the EPAct.

What complainants attempted to do here was to establish substantially changed circumstances utilizing a test period concept based on the twelve month period preceding the enactment of the EPAct on October 24, 1992. This is an arbitrary date that has no necessary correlation to the economic circumstances that were the basis of the rate at the

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[69] Chevron shows the increase in West Line volumes as:

Period	Volumes (In Barrels)	Increase
Nov. 1991 - Oct. 1992	28,245,011	N/A
Nov. 1992 - Oct. 1993	36,142,011	27.96%
Nov. 1993 - Oct.1994	37,020,946	31.07%
Nov. 1994 - April 1995	38,532,907	36.42%

See Chevron's Brief on Exceptions, at corrected page 24. Other parties make different calculations but the results are in the same range. SFPP's 1996 10-K showed increases in West Line volumes over 1992 of 28.21% in 1993, 33.33% in 1994, and 43.20% in 1995. *Id.*

[70] 49 FERC ¶ 61,081 (1989).

time it was designed. In context, it is relatively clear that economic basis for the rate is the basis upon which the rate was last considered to be just and reasonable, either as a filed rate, a settlement rate, or one for which the Commission has made a legal determination. Otherwise, the economic basis for all oil rates would be the status of the principal design factors at the time the EPAct was enacted. Such a definition would be arbitrary because the actual economic performance of the company at any time (throughput, etc.) in relation to the design of a particular rate can vary and performance may have no correlation to the factors that are the actual economic basis used to design the rate.

In contrast, SFPP's discussion of the history of its West Line improvements supports the conclusion here. SFPP asserts that the initial results of the expansion were disappointing, that its West Line volumes declined in 1990-1991 under the impact of base closings and a recession, and then recovered in 1992.[71] Moreover, SFPP's explanation is consistent with the complainants' perception that as late as 1992 the West Line was frequently operating well below capacity.[72] Given the interpretation of Section 1803(b)(1)(A) adopted here, SFPP has correctly argued that the increase in volumes in 1993 over 1992 could be attributed to an economic rebound, the execution of new contracts such as the ARCO Reversal Agreement, and other factors whose full impact came only after the first complaints were filed. In fact, on this record it is not possible to tell whether even the increased throughput through 1992 and 1993 had by that point raised throughput (and returns) to the level embodied in the rates

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[71] Exh. 147 at 5-6, 10.

[72] Prepared Direct Testimony of Andrew W. Battese, Exh. 34 at 16.

utilized to implement the West Line expansions. For example, the West Line does not appear to have been subject to prorationing until early 1996.[73]

Under the EPAct, the complainant must establish that there has been a substantial change in the economic circumstances of the pipeline that are the basis for the rate at the time the complaint is filed. The Commission finds they failed to do so. The parties filing consolidated complaints before August 7, 1993, agreed to accept the record developed by the other complainants, and as such the later complaint suffers from the same limitation as the earlier complaints in that they measure substantially changed circumstances against the wrong base period.

On a subsidiary point, on exceptions the West Line Shippers assert that the ALJ erred in not ruling that post-complaint evidence can be considered in determining whether there are substantially changed circumstances, in this case on the issue of volumes. For support, they cite the Commission's willingness in *Santee Distributing Company v. Dixie Pipeline Co.*[74] to look at events in 1995 to evaluate a

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[73] Tr. At 5472. While the Commission does not have before it an analysis of what economic assumptions may have been involved in designing the current West Line rates, the Commission assumes that the shippers would not have agreed to a settlement rate that was not based on a reasonable projection of the volumes and the costs that would result from the expansions they were contesting. To have done so they would have had basic rate design information available to them to determine whether the 1988 Settlement suited their interests.

[74] 71 FERC ¶ 61,205 (1995), *reh'g denied*, 75 FERC ¶ 61,254 (1996).

complaint filed in October 1994. SFPP asserts on rebuttal that while the Commission did so, its action was beyond the literal words of the statute.

The Commission concludes that SFPP has the better argument on this point. While the statute does not literally address the matter, it states that the complainant must present evidence to the Commission which establishes that a substantial change has occurred after the date of enactment of the Act.[75] It is difficult to see how language that so explicitly uses the past tense could apply to evidence that would be developed at some indeterminate time after the complaint is filed, particularly since an initial determination on substantially changed circumstances is required if the complaint is to proceed to hearing on the issue of reasonableness. Otherwise, the date for determining whether substantial evidence exists becomes a moving target lacking in any certainty in the time frame to be addressed, even though, in contrast, reparations for a rate deemed to be just and reasonable are fixed as of the date of the complaint. If post-complaint evidence should eventually point to a different answer than any pre-compliant evidence, the answer is to file another complaint, which in fact several complainants have done. Thus, to the extent the parties rely on data that occurred after their complaints were filed to establish substantially changed circumstances, this was incorrect.[76]

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[75] Section 1803(b)(1) of the EPAct.

[76] In *Santee*, *supra*, the Commission did look at Form 6 data that was compiled after the date of the complaint, this was for the narrow purpose of validating the Commission's decision, on rehearing, to dismiss the complaint without further action. This was done solely because of the summary nature of the action to be taken by the Commission and to avoid injustice. In the instant case

The Commission affirms the ALJ's conclusion to reject complainant's efforts to use the increases in West Line volumes that occurred after their complaints were filed to establish a substantial change in the economic circumstances of the pipeline that were the basis for the rates at issue here.

(2) The Filing of Tariff No. 18

On December 31, 1992, SFPP filed Tariff No. 18 providing for the transportation of turbine (jet) fuel to Phoenix. Chevron and the West Line Shippers argued that this new tariff constituted substantially changed circumstances. Chevron also asserted below that the ARCO Reversal Agreement, which provided guaranteed throughput for turbine fuel, constituted substantially changed circumstances. In both instances the theory was the increased volumes meant greater efficiencies. The ALJ held otherwise, concluding that Tariff No. 18 was a non-grandfathered rate and did not constitute substantially changed circumstances in any event.[77] The complainants renew their arguments on exceptions.

The ALJ is affirmed. The filing of a new tariff in itself is of no import for the issue of substantially changed circumstances. While an increase in volumes might result in substantially changed circumstances in a different case, this did not even remotely occur in this proceeding. The projected increase in volumes was 365,000 barrels per year on a line whose base volumes for 1993 are estimated by

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the complainants had a full opportunity for discovery after the case was set for hearing.

[77] 80 FERC at 65,195.

complainants at 32,850,000 barrels per year, an increase of slightly more than 1 percent.[78] The complainants have clearly failed to show how the relatively low volumes shipped under Tariff No. 18 are a changed circumstance, and any such analysis suffers from the same infirmities as the complainants' other use of increased volumes.

(3) Changes in Environmental Regulations.

The West Line Shippers argued that changes in California environmental regulations would prohibit the sale of certain types of gasoline in California after 1996, and that these changes would lead to a substantial increase in volumes on the West Lines. The ALJ rejected this argument, concluding that it is conjectural.[79] He cited the statutory language providing that the complainant must establish that a substantial change has occurred, and correctly concluded that the language bars an argument based on an event that is so far removed from the date of the complaint. The West Line Shippers renew their arguments here. The ALJ is affirmed for the reasons stated in his order.

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[78] See 80 FERC at 65,814.

[79] *Id.*

(4) The Commission's *Lakehead* Decision

In 1995 and 1996, the Commission issued two decisions in *Lakehead Pipe Line Company, L.P.*[80] that redefined Commission policy on the rights of oil pipelines organized as limited partnerships to include certain income tax allowances in their cost of service. The complaining parties assert that this represented a substantial change in economic circumstances since the inability to recover a significant cost allowance represents a substantial change in their economic circumstances. The ALJ held that a change in Commission policy that may subject a grandfathered rate to possible revision is not a substantial change in the economic basis for that rate. The complainants renew their argument on exceptions. The Staff asserts that the EPAct should not be construed to insulate pipelines against changes in Commission policy. SFPP supports the ALJ's interpretation.

The Commission will affirm the ALJ but on different grounds. The EPAct has no legislative history on whether a rate that is deemed to be just and reasonable under the EPAct may continue to be so deemed in perpetuity if a major component of that rate were to become inconsistent with Commission policy through subsequent Commission action. What is clear is that regulatory change is a well recognized risk of doing business and may significantly affect the economic basis of a pipeline's rate structure as much as its own commercial policies or the extrinsic economic environment.[81] In light of this established case law, the

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[80] 71 FERC ¶ 61,338 (1995), *reh'g denied*, 75 FERC ¶ 61,181 (1996).

[81] *See Texaco Inc. and Texaco Gas Marketing, Inc. v. FERC*, 148 F.3rd 1091, 1098,(D.C. Cir. 1998); *See also*, Exh. 866, SFPP

Commission concludes that Congress did not intend that a pipeline may maintain an element in its rate structure in perpetuity if that element clearly violates Commission policy.

However, the Commission also concludes that a change in Commission policy does not in and of itself establish substantially changed circumstances without a demonstration that the policy change caused a substantial change in the economic basis of the rate at issue. A mere allegation that a rate element violates Commission policy is inadequate. Here the complainants did not establish that such a change would result from the application of the *Lakehead* policy to SFPP. Rather, they simply asserted that the existence of the *Lakehead* policy constitutes substantially change circumstances without how this affects the economic basis for the rates that are challenged here. The ALJ's ultimate conclusion is affirmed.

(5) The Initiation of the Instant Complaints.

West Line Shippers argued below that the filing of the complaints in the instant case constituted substantially changed circumstances in and of themselves because the Commission in its orders approving the 1985 Settlement left the subject rates open to challenge at a later date. The ALJ concluded that a Commission order in effect before the provisions of the EPAct were effective could not supersede the statute.[82] The West Line Shippers renew this argument on exceptions. SFPP, Navajo, and the Staff support the ALJ. The Commission agrees that a routine reservation of jurisdiction

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1996 SEC Form-10 at 5-6.

[82] 80 FERC at 65,196.

in a Commission order cannot override a specific statutory provision enacted after the order issued and the ALJ is affirmed.

c. Procedural Considerations

The Staff asserts on exceptions that the Commission should clarify the purpose and intent of the substantially changed circumstances portion of the EPAct. In particular, the Staff suggests that there is considerable confusion regarding the degree of proof that is required to meet the jurisdictional threshold and the procedural framework in which a determination of substantially changed circumstances should be made. Staff suggests two possible alternatives for addressing the issue of substantially changed circumstances. One is that the complainant must satisfy the test before proceeding to hearing on the merits, even if this means limiting the complainant's access to discovery and additional materials. Another would be to make a preliminary determination to be followed by a final determination on the record. Staff also raises the issue of whether a complainant must address all the factors that determine whether a rate is just and reasonable or only those elements which the complainant believes reflect a substantial change.

The complainants also assert that the instant case provides an example of how evidentiary and procedural issues can present barriers to a party attempting to establish substantially changed circumstances. Chevron argues publicly available information would not have permitted it to establish substantially changed circumstances regarding the West Line rates in the instant case because only the volumes were readily available. It asserts that additional information on operating costs, and the supplemental information on volumes in the later years, became available only after discovery in the

instant case, as did the segment specific information required in this case. Chevron concludes that it is impossible to determine substantially changed circumstances at the Commission level given the data that is available in the current version of the Commission's Form No. 6 and annual reports to the SEC. SFPP asserts that the issue of substantially changed circumstances should be decided at the outset of the case and that Staff's suggested clarifications should be denied.

The Commission concludes that the complainants' concerns regarding their opportunities to establish substantially changed circumstances are overdrawn. In the instant case, discovery was permitted before any determination was made. The complainants' efforts to establish substantially changed circumstances failed not from a want of adequate information, but from failure to advance a sustainable theory or to address the proper economic basis for the rate. The Commission does recognize that in the instant case it would have been difficult for a complaining party to attack an existing rate based on a settlement without access to information about the costs, revenues, and volumes that underlie SFPP's settlement rates. For this and other reasons, it may be necessary to permit the issue of substantially changed circumstances to go to hearing in order to obtain a fair result. In fact, the Commission did so in this case, concluding that, the complainants had made a sufficient showing to warrant referring the matter for further consideration by an ALJ.[83]

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[83] SFPP, L.P., 65 FERC ¶ 61,028 (1993).

By comparison, in its first Santee order the Commission concluded that much of the evidence of increased volumes and returns addressed the period before the enactment of the EPAct and therefore could not be utilized to establish substantially changed circumstances. The Commission also concluded that the volume increases after the effective date of the EPAct were minimal, in the range of 2.8 percent, and that Santee had not adequately explained the basis for its expense calculations.[84] On rehearing, the Commission performed its own analysis of changes that had occurred after the EPAct, and again found that there was no basis to proceed with the complaint.[85] In contrast, while in the instant case the Commission has found that the complainants have not met their burden after completion of a hearing, the relative increase in volumes alleged in the instant docket was several orders of magnitude greater than in *Santee*.[86] Since volumes are a major component in the rate design of an industry having strong economies of scale, the Commission sent the issue of substantially changed circumstances to hearing in this proceeding, including the right to discovery given the limitations of available information. In any event, the record in the instant case indicates that it is not impossible to estimate the economic value of a settlement even if the details are not provided in the settlement document. For example, Staff reviewed the rates filed by SFPP pursuant to its 1990 settlement with Navajo and estimated the return, which SFPP disputed.[87]

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[84] See 71 FERC ¶ 61,205 at 61,754 (1995).

[85] See 75 FERC ¶ 61,254 at 61,621 (1996).

[86] See footnote 89.

[87] See Exh. 864, dated December 20, 1990.

Thus, in response to the concerns expressed by Staff and Chevron, a review of this case and other proceedings since the EPAct indicates that the Commission has been willing to refer a complaint, and therefore the issue of substantially changed circumstances, to hearing when the initial filings raise a colorable argument that there a substantial change has occurred in the economic circumstances that are the basis for the rate. This opportunity does not remove a complaining party's burden of establishing at the outset that there are substantially changed circumstances meriting further investigation of the rate itself.[88] Thus, where a complaint has been scheduled for hearing, substantially changed circumstances is a threshold issue that should be addressed and decided before proceeding to litigate the merits of whether the challenged rate is just and reasonable. This will permit the presiding ALJ to dismiss the complaint if it is determined there are no substantially changed circumstances, thereby saving considerable time and resources for all parties.

d. Allegations of Undue Discrimination and Prejudice.

The West Line Shippers assert that the ALJ erred in not discussing whether a failure to adjust all of SFPP's rates prospectively, in the event some of the existing rates are changed, would be unduly discriminatory. They assert that Navajo was permitted to settle on the matter of West Line

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[88] For example, the throughput, revenue, and returns on the West Line in 1994 may not have substantially exceeded the economic assumptions embodied in the basis of the rates placed in effect in 1989. However, in later proceedings based on subsequent complaints the complainant might establish that the assumptions that underlie the economic basis for the rate have been substantially exceeded, and there has been a substantial change in the circumstances that are the basis for the rate.

Rates provided that its withdrawal would not prejudice the rights of the other parties. The West Line Shippers argue that the Commission has jurisdiction over discrimination issues regardless of the EPAct, and that to adjust one rate on the West Lines without adjusting all rates would result in an unduly discriminatory result since there would be no cost justification for the result.

The Commission affirms the ALJ. First, while Navajo's Settlement was conditioned on it not prejudicing the other parties to this proceeding, this condition can only address the integrity of the record, not to the settlement terms. When it comes to the terms, settlements are intrinsically unique, and is quite possible for different parties to obtain different settlements, all of which are just and reasonable based on the particular circumstances of the parties involved. Just as the other parties may not piggyback on Navajo's complaint,[89] they cannot piggyback on Navajo's settlement in order to achieve the substantive goals as long as the Navajo settlement is consistent with the public interest. Otherwise the requirement under the grandfathering provisions of the EPAct that each party prove the merits of its own complaint would be nullified by linking unrelated complaints and any resolution that may result.

Second, since the rate for turbine fuel is not grandfathered, the rate for this commodity may be adjusted as the result of an investigation even if other rates appearing on the face of the same tariff are unchanged. A resulting rate might well be lower than the rate for all other products and services now contained in the same tariff, but this result would not be unduly discriminatory if based on the just and

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[89] SFPP, L.P., 68 FERC ¶ 61,105 at 61,581-82 (1984).

reasonable standards the Commission normally applies in oil pipeline cases. While there would be no cost justification for the difference in the two rates, the difference would flow directly from the procedural provisions of the EPAct. If, as a result of the grandfathering provisions of the EPAct, different rate levels result because the differing rates became effective at different times, this is a function of the statute. To hold otherwise would nullify the grandfathering provisions of the EPAct.

3. The Watson Enhancement Facilities.

Watson Station is a major origin point for volumes moving on the West Line. In March 1989, SFPP notified its shippers that it was increasing the minimum pumping rate and pressure at Watson Station and required its shippers to meet the higher standards in two phases, the final pressures to be effective April 1, 1992. SFPP's shippers were given the option of providing their own facilities to meet the increased pressure requirements or to pay SFPP a charge to provide the necessary services. At the time the instant complaints were filed all the relevant shippers had executed contracts to pay the charge rather than to construct their own facilities. SFPP constructed and now operates the Watson enhancement facilities, which serve to increase the capacity and efficiency of shipper storage facilities in the Watson Station area.

In reviewing the complaint by Chevron, the ALJ determined that the Watson enhancement facilities were jurisdictional, and that SFPP must publish a tariff for providing the services and include the revenues and costs in its West Line cost of service.[90] The ALJ also concluded that

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[90] See 80 FERC at 65,154-55.

no reparations or revenue crediting would be required for the period preceding SFPP's filing of an appropriate rate with the Commission. SFPP excepts to the conclusion that the facilities are jurisdictional, asserting that the enhancement services it provides at Watson Station are ancillary services provided for the convenience of the shippers. However, it supports the determination that no refunds should be made. The complainant parties and the Staff support the ALJ's determination on the jurisdictional issue but the West Line Shippers oppose his determination that no refunds need be made for the period that SFPP has no tariffs for the Watson enhancement services on file.

The Commission will uphold the ALJ's determination. The ALJ carefully detailed how all volumes tendered to SFPP by shippers tendering oil products at Watson Station must pass through the enhancement facility since the shippers do not possess facilities of their own.[91] It is undisputed that much of the volume moving through the enhancement facilities moves in interstate commerce and that shippers intend that much of the volumes tendered were to move in interstate commerce. Construction of the shippers' own facilities or the use of SFPP's facilities is a prerequisite of use of SFPP's system for interstate shippers tendering volumes to SFPP at Watson station in order to meet the minimum pumping requirements contained in SFPP's tariff, and has been since November 1, 1991. The fact that contracts were executed for provision of the service does not detract from the fact that SFPP imposed a mandatory choice on its shippers, and modified its FERC tariffs to assure compliance with its needs.

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[91] See 80 FERC at 65,156-57.

It is the mandatory nature of the pressure requirements that renders SFPP's argument that the service is ancillary unconvincing. For example, SFPP cites an earlier Interstate Commerce Commission case holding that a service charge for the compression of cotton was ancillary.[92] But in that case the shipper had the option of shipping either compressed or uncompressed cotton, and the failure to provide compressed cotton (whether or not the shipper or the carrier did the compression) did not bar access to the common carrier railroad system. To the extent such earlier ICC cases are relevant, the ALJ's citation of *Atlanta Pipe Line Company*[93] is more appropriate. In that case the ICC held that tank storage facilities necessary for the practical operation of the pipeline system were subject to its jurisdiction, and that the pipeline was required to provide them.

The ALJ's conclusion is well reasoned and consistent with the Commission's recent decisions involving SFPP's *Sepulveda* line[94] and *Lakehead Pipe Line Company*.[95] The Commission therefore affirms his conclusion that SFPP's Watson enhancement facilities are subject to the

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[92] See SFPP's Brief on Exceptions at 67, citing *New Orleans Cotton Exchange v. Louisville and Nashville R.R. Co.*, 46 I.C.C. 712, 725 (1915), modified 49 I.C.C. 271 (1918).

[93] 47 I.C.C. Val. Rep. 541 (1937), discussed at 80 FERC ¶ 65,157.

[94] *Texaco Refining and Marketing v. SFPP*, 80 FERC ¶ 61,200 (1997) (*Sepulveda*).

[95] 71 FERC ¶ 61,338 at 62,324-26 (1995), *order on reh'g*, 75 FERC ¶ 61,181 at 61,660-01 (1996). See Staff's Brief Opposing Exceptions at pages 29-36 for a particularly concise and appropriate discussion of this issue.

Commission's jurisdiction. The ALJ also held that SFPP would not have to credit the revenues received to date or to make reparations. Chevron asserts that this was error, stating that the latter ruling is inconsistent with the Commission's *Sepulveda* decision, and inconsistent with his own determination that the costs of the facility have been recovered several times over. Neither argument is persuasive here. It is true that in Sepulveda the Commission required SFPP to publish a rate and held open the prospect of reparations once the related rate issues had been determined. However, in that case the underlying contracts had expired and the parties were disputing what the rate should be for continued service.

For the period at issue here the contracts were still extant, the charge was established by negotiation, and the contracts were entered into voluntarily by the parties, mostly before the end of 1991. The typical Watson Station enhancement facilities contract contains detailed provisions on the charge, the term, the pressure to be maintained, and the minimum annual throughput required to support the construction of the Watson Station Line.[96] A contract of this sophistication requires a good deal of thought and negotiation on the part of parties. As such, this Commission can assume they were reasonably aware of their rights and obligations under the Interstate Commerce Act. In this regard, Chevron and others had approximately two years in which to make the decision to build their own facilities or to enter into a contract under which SFPP would construct the facilities and amortize them for a specific charge designed to recover the costs of the facilities over the life of the contract.

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[96] See Exh. No. 124.

During that time no party chose to formally protest SFPP's tariff requirement calling for increased pressure for deliveries in the Watson Station area or to bring the jurisdictional issue to this Commission. Nothing would have prevented a sophisticated shipper like Chevron having filed with the Commission on the jurisdictional issue in a more timely fashion. Under these circumstances, the complaint against the Watsonville charge is arguably little more than an attempt to avoid a previously negotiated contract, agreements the Commission has held are lawful under the ICA.[97] While the Commission has little choice under controlling authority but to assert its jurisdiction over the movements at issue here, the exercise of that jurisdiction to alter that charge would be inequitable given the parties' intention to resolve the issue through a number of interlocking contracts allocating the costs of the facilities among several shippers.[98]

The issue of timeliness raises a second point that goes directly to the Commission's legal ability to exercise its

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[97] See *Express Pipeline Company*, 76 FERC ¶ 61,145 at 62,254 (1996), citing at n. 4, *Sea-Land Services, Inc. v. ICC*, 738 F.2d 1311, 1316 (D.C. cir. 1984), *order denying reh'g*, 77 FERC ¶ 61,145 (1996). The result here is consistent with the holding in that proceeding. The Commission notes that there is no current obligation to file an oil pipeline transportation contract with the Commission.

[98] The facilities appear to have been designed to reflect the total needs of all the shippers that agreed to use the facilities. The contract terms would normally reflect the most efficient terms for facilities of that size and scale and would allocate the risk among the various parties. Modifying the terms for one party by reducing its rate gives that party an unbargained for, and unwarranted, advantage.

jurisdiction. It appears on this record that all the relevant contracts were required to be, and had been, executed well before June 1, 1992. While the contract charge was not a rate filed with this Commission, the charge itself was clearly established before the effective date of the EPAct. The complaint here is against both the jurisdictional issue and the level of the charge. The clear purpose of the EPAct's grandfathering provisions is to insulate pipelines from challenges to the rates and charges that pipelines assess their shippers for common carrier services if those charges were in effect before October 24, 1992. If the Watson Station enhancement services are common carrier services, and the Commission has so held, then the full range of legal provisions applicable to those services should apply to assure consistency in the implementation of the statute.

Therefore, while the Commission will direct SFPP to file a rate equal to the historic charge in the shipper contracts, it will dismiss complaints against the charges under the Watson Station facilities contracts since those contacts were effective at the time the complaints were filed. Moreover, as long as the underlying contracts are in effect, the charges for the Watson Station facilities are part of enforceable contracts and are the equivalent of a lawful, effective rate.[99] Given the restrictive purpose of the statute and the lawful nature of the existing changes the Watson Station enhancement services, the Commission finds that any party challenging those charges while the contracts are in effect must establish substantially changed circumstances in order to do so. Chevron has not done so, and therefore its complaint against the level of the

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[99] As in *Sepulveda*, *supra*, once the contracts expire SFPP must maintain a tariff on file with the Commission if it continues to assess a charge for use of the Watson Station facilities.

Watson Station facility charge fails.[100] The ALJ's conclusions are affirmed.

4. The ARCO Reversal Agreement.

As detailed in the background section, in mid-1992 SFPP entered into an agreement with ARCO to reverse the flow of its 6 inch-diameter line between Tucson and Phoenix, Arizona, from an eastbound to a westbound service. This engendered disputes about whether the Commission had jurisdiction over the reversal of the flows and whether the terms of the so-called ARCO Reversal Agreement must be published in SFPP's tariff. The ALJ held that the reversal of the six inch line was not subject to the Commission's jurisdiction because it constituted an abandonment of service. He also held that the essential terms of the Agreement must be published in SFPP's tariff because they are an integral part of the tariff and the rate to be paid. He also held that the Reversal Agreement is not unduly preferential or discriminatory and that ARCO was not entitled to a revenue credit for volumes that were not shipped under the Agreement.

On exceptions, ARCO asserts that the ALJ erred in refusing to require revenue crediting or return of ARCO's payments and in rejecting ARCO's interpretation of the Agreement. The West Line Shippers assert that the ARCO Reversal Agreement was unlawful because it provides for a minimum volume, that this results in an unlawfully high rate,

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[100] The charge at issue is a special charge designed to amortize the costs of the facilities at issue. If the amortization was complete and there was no further basis for the charge, then the complaint would probably lie. But this has not been alleged or established for the period at issue here.

and because SFPP violated a Commission order[101] when it temporarily used the 6-inch line in East Line service while SFPP was undertaking its East Line expansion work. The Staff asserts that the ALJ correctly held that the Commission had no jurisdiction over the decision to reverse the line, and that SFPP must publish the terms of the ARCO Agreement in its tariff. SFPP first asserts that the ARCO agreement has expired and therefore there is no need to address its merits. If the merits are to be addressed, SFPP agrees that the ALJ correctly held that the Commission was without jurisdiction over the decision to reverse the line and with his conclusion that the agreement is neither unlawful nor unduly discriminatory. It disagrees with his determination that the terms of the Agreement are integral to the rate and must be published in SFPP's tariff.

The Commission will address certain of the issues regarding the ARCO Agreement since the ARCO Agreement was in effect during in the time frame addressed in the complaints. The ARCO Agreement was executed in June 1992, and shortly thereafter the 6-inch line between Phoenix and Tucson was restored to west to east service. Prior thereto, as noted, the line had been operated in west-to-east service before being shifted to east-to-west service. Thus, SFPP has twice reversed the flow of the 6- inch line between Tucson and Phoenix.

As noted, the West Line Shippers assert that the first reversal violated a Commission order approving rates for the flow of volumes between Phoenix and Tucson and that SFPP

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[101] 45 FERC ¶ 61,242 at 61,714-15 (1988), which approved the 1988 settlement containing the stated rates to apply to the West Line after the 1988-1989 expansions were completed.

should not have reversed the line without canceling its tariff for west to east service. First, the Commission affirms the ALJ's decision that the Commission does not have jurisdiction over SFPP's decision to reverse the flow of the 6-inch line.[102] Each time the line was reversed, this constituted an abandonment of all west-to-east, or east-to-west, service over the 6-inch line. Abandonment of service by an oil pipeline is not subject to the Commission's jurisdiction. While it might have been better form for SFPP to have canceled the relevant tariffs, SFPP clearly provided notice to its shippers that it was not holding itself out to provide at that times it reversed the 6-inch line and operations ceased accordingly. Given the lack of jurisdiction over the reversal of the line, a protest to the tariff cancellation would have been dismissed, contrary to complainants' assertions. Moreover, as SFPP was under no obligation to establish or maintain the west-to-east flow in the first place, SFPP could not have violated a Commission order "establishing" the service. Construction, entry and abandonment of service by oil pipelines are not subject to the Commission's jurisdiction.

The Commission also concludes that the Agreement was not unlawful or unduly discriminatory. Agreements for minimum throughput, with annual volume and revenue guarantees, are common in the oil pipeline industry.[103] There is no indication on this record that the Agreement was for less than the maximum tariff rate, that the Agreement precluded

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[102] See *ARCO Pipe Line Company*, 55 FERC ¶ 61,240 at 62,263 (1991), *order on reh'g*, 66 FERC ¶ 61,159 (1994).

[103] As noted, the contracts supporting the construction and operation of the Watson Station dry drain facilities typically contain a minimum volume provision. See Exh. 124.

other shippers from having access to capacity,[104] or that any form of rebate was involved. West Line Shippers do assert that since ARCO paid an average per barrel charge in some years that exceeded the maximum rate, the Agreement violated SFPP's maximum rates. This is a specious argument. The higher average per barrel rate occurred because ARCO did not ship the minimum volumes required under the Agreement, and therefore the dollars due under the contract were simply spread over fewer barrels than the minimum number required by the contract. The ALJ's conclusion on this point is affirmed.

The Commission also affirms the ALJ's determination that ARCO is not entitled to any revenue credits or refunds. He correctly stated that ARCO agreed to pay a fixed annual amount in exchange for capacity being made available to it on the 6-inch line between Phoenix and Tucson, that ARCO is liable, and that any other contractual interpretation is unreasonable. However, the Commission will reverse the ALJ's determination that the terms of the Agreement must be published in SFPP's tariff. Several of the parties assert that an agreement to reverse the flow of a line is unique, but this point is irrelevant since the Commission lacks jurisdiction over such a decision to reverse the line in the first instance. Once the decision was made, the Agreement provided for transportation at the filed tariff rate.

Thus, contrary to Staff's and the ALJ's assertion, the Agreement was not an integral part of that rate because it was based solely on the tariff rate. The related volumes, the revenues, and the term of the contract would clearly be

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[104] In fact, the parties agree that the West Line was underutilized at most times relevant here. See n. 86, *supra*, and n. 120, *infra*.

relevant to designing a rate in a maximum rate case; to that extent they would be integral to a rate at issue in such a proceeding. But SFPP was not attempting to design a rate through the use of the Agreement; it was simply applying the rate on file. The Commission has not heretofore required oil pipelines to publish the details of throughput agreements in their tariffs and it will not do so here. If the Agreement resulted in a discriminatory allocation of capacity, the Commission could exercise its jurisdiction, but there is no credible assertion here that this has occurred. A general concern that discrimination may occur in the allocation of capacity is insufficient to sustain the remedy sought here.

5. Conclusions

The Commission affirms that the West Line Shippers and Chevron must establish substantially changed circumstances for all of the West Line rates they have challenged except for that portion of Tariff No. 18 that addresses turbine fuel. The Commission has also concluded that the West Line Shippers and Chevron failed their burden in that regard. Moreover, since Navajo has settled its disputes with SFPP regarding the West Line rates, the only West Line rate that remains before the Commission at this point is the turbine fuel component of Tariff No. 18.[105] Therefore no further action will be taken on the complaints filed against SFPP's West Line rates through

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[105] The daily incremental volumes for this service are estimated at 1000 barrels per day on a West Line Capacity in 1995 of 173,000 barrels a day (Colton to Phoenix). See Exh. No. 413 and 75 FERC at 80 FERC at 65,818. As noted, Chevron estimates the incremental return at .322 percent. See Exh. No. 413. Other than complainant's efforts to establish substantially changed circumstances, there was no substantive basis upon which to challenge this rate.

August 7, 1995, the date of the last consolidated complaint at issue here. The Commission also finds that the charges for the use of SFPP's Watson enhancement facility are barred in the absence of substantially changed circumstances and that issue will not be pursued further here.

Moreover, the Commission concludes that there is no reason for further review of the turbine fuel portion of the Tariff No. 18. As the complainants themselves have stated, there are no operating differences, or attendant cost differences, between providing this service and the other services provided under Tariff No. 18. Since the rates for all other services and products transported under Tariff No. 18 are deemed to be just and reasonable, there is no basis for providing a different rate level for turbine fuel at this time.

In light of this conclusion, the Commission will not review further the ALJ's determinations related solely to West Line rates, including: (1) allocation of overhead administrative costs between SFPP's jurisdictional and non-jurisdictional lines in the State of California, (2) the level of the charge for the Watson enhancement facilities, (3) the specific rate issues related to the ARCO Reversal Agreement, (4) the proper method for allocating revenues to the Cal/Nev lines, and (5) reparation issues related to the West Lines. The proper allocation of costs between the West and East Lines is discussed in the next section.

B. Rate Design Issues.

SFPP operates two distinct pipeline systems, the North System, which operates between the Los Angeles basin and the Pacific Northwest, and the South System between the Los Angeles Basin and El Paso. The South System has historically involved two different flows, one between Los

Angeles and Tucson via Phoenix (the West Lines), and the other between El Paso and Phoenix via Tucson (the East Lines). As has been described, the shippers on the West and East Lines often compete to sell products in the Arizona market, and the two lines have different rate structures. The fact that SFPP has different rates on different parts of its system has raised a number of fundamental rate design issues.

1. The Use of a System Rate Ceiling.

The ALJ held that SFPP must establish the reasonableness of each of the rates that were challenged in the instant proceeding and that the maximum rate that could be charged for each such rate was the fully allocated cost of that rate. He also held that SFPP must provide separate cost justifications for the East and West Lines. SFPP and the Association of Oil Pipe Lines (AOPL) excepted to this finding.[106] They argue that Commission precedent does not limit oil pipelines to the recovery of fully allocated costs, that Congress and the Commission have consistently contemplated that oil pipelines would be subject to more light-handed regulation than gas pipelines in determining rate design issues. SFPP also asserts that it has consistently operated the South System as a single entity and that therefore any rate ceiling should apply to the service of that system as a whole. Staff and the complainant

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[106] AOPL requested permission to file an amicus brief on exceptions with the Commission in this proceeding. The request was opposed on the grounds that AOPL had not participated in the proceeding and had no familiarity with the record. The Commission concludes that AOPL's proposed brief goes to issues of general law and policy and that any discussion of by AOPL of those issues is adequately supported by facts that are stated in the initial decision. Since all parties have had an opportunity to respond, they are not prejudiced and the Commission will accept AOPL's brief.

parties support the ALJ's decision, asserting that the cases cited by SFPP in support of its position are inapposite, that fully allocated cost is the normal standard for determining a maximum rate, that SFPP's East and West Lines have substantially different cost structures, and that any use of system wide cap will result in substantial allocation of West Line costs to East Line shippers.

The Commission will affirm the ALJ in part and modify his order in part. First, SFPP and AOPL are correct that oil pipelines are not necessarily limited to the use of a fully allocated cost ceiling as a justification for their rates, and they are equally correct that there are other theories available under the Interstate Commerce Act.[107] To the extent the initial decision is to be read as a categorical statement that fully allocated costs are the only methodology for evaluating an oil pipeline maximum rate, that portion of the initial decision is reversed.

However, the issue of a fully allocated cost cap is not the essence of the dispute between the pipeline interests, the complaining parties, and the Staff in this proceeding. The focus is on the costs to which any rate cap should be applied and the nature of the cap. On the first point, SFPP argues that any rate ceiling should be based on the costs of the South System as a whole and not the East and West Lines separately. This assertion is unreasonable both as a matter of law and the practical economics of rate design. On the matter of law, SFPP and AOPL assert that the Commission has never required that the reasonableness of rates be determined on an individual rate basis and that the Commission has dismissed

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[107] See *Williams Pipe Line Company*, 84 FERC ¶ 61,022 (Opinion No. 391-B)(1998)(Williams).

complaints where the revenues were less than the system wide cost of service. However, as the complainant parties and the ALJ properly state, in *Farmers Union Central Exchange v. FERC*, the Court specifically stated:

> Because oil pipeline rates are charged on a point-to-point basis, such cost allocation [by shipment] ensures that the costs of providing service over a given territory will be recovered only from the companies that use that particular service.[108]

Farmers Union is still controlling law, and the Commission's subsequent decisions are consistent with this admonition, as is the ALJ's ruling that the maximum rates for the East and West Lines must be calculated separately. For example, as pointed out by Refinery Holding Company (RHC), in *ARCO* the parties stipulated which of the pipeline's services, i.e. which products, would be the subject of the proceeding, the cost of service for transporting those products, and for providing the services under those specific tariffs. Since the subject rates generated less revenue than the stipulated costs for the service at issue, the Commission dismissed the complaint. Similarly, the challenge to Lakehead's rates was to those for transporting crude oil and natural gas liquids through the pipeline's entire system. SFPP's own rate structure in this proceeding indicates that its citation of *Lakehead* is inapposite. The issue here, as in *Williams*, *supra*, is how costs should be allocated to services with two distinctly different rate structures. The Commission stated in *Williams*, that regardless of what maximum rate

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[108] 734 F.2d at 1528-29.

methodology is adopted, the object is to assure that shippers pay for the costs of the services that they are using.[109]

Applying the *Williams* analysis, SFPP's assertions that the South System is a single system for rate design purposes lacks a credible foundation. The rates at issue here serve different markets and different shippers, often competitors, and the rates themselves reflect differently sized pipelines and different patterns of investment. These are enumerated on pages 25 and 26 of RHC's Brief on Exceptions. For example, the West Line has about twice as many terminal and pump stations as the East; the West Line has 83 percent of the throughput and the East Line 17 percent of the South Lines' total; depreciation expense was allocated some 77 percent to West Line; and planned investment on the West Line in the late 1980's was $170 million, with actual investment amounting to $140 million, compared to $48 million on the East Line in the early 1990's. RHC correctly argues that there is no convincing evidence that most East Line shippers receive any benefit from the $140 million invested in the West Lines, and that a system wide approach would require East Line shippers to pay for large amounts of capacity that many have no reasonable prospect of using. Together with other parties, it correctly asserts that utilizing a system wide cost-of-service and a system-wide rate cap, would result in a large cost shift from the West Line to the East Line. To the extent there is excess capacity on the West Lines, as is indicated in this record,[110] the cost shift to the East Line shippers would be accentuated. This is reflected in the

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[109] 84 FERC at 61,099-100, 61,104, 61,110-11, 61,113.

[110] See Exh. 34 at 16.

perception of one witness that the West Line was operating at less than 50 percent of capacity in 1994.[111]

Moreover, SFPP's arguments that the two lines have certain common facilities, services, and required coordinated operations means nothing more than the fact that SFPP is multi-product firm with significant amounts of joint and common costs. The fact these costs exist, and that a number of shippers may use both lines at different times or simultaneously, is simply not relevant here. If SFPP's shippers shift volumes from the East Line to the West Line, or vice versa, they are still utilizing a different service between different markets, provided by means of different assets in order to reach their markets. Any such shifting of traffic does not warrant exposing customers that do not engage in large volume shifts to the cost shifting that would result under SFPP's proposal. SFPP's rate structure in its current format reflects the fact that the underlying transportation economics of the East and West Lines are different, particularly as regards their relative volumes and investment bases.

Under its 1988 settlement, SFPP's current South System rates were designed to accommodate the large difference in investment between the West and East Lines that SFPP planned to make following its 1985 settlement, and to avoid the very cross- subsidy that would likely result if a rate ceiling were now designed on a system-wide basis. Finally, to the extent SFPP asserts that it should be permitted to recover revenue shortfalls in some markets by recovering revenues in

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[111] See Prepared Direct Testimony of Andrew W. Battese, Exh. 34 at 16. The statement on utilization is as of June 1994 and is uncontroverted.

excess in other markets without a more definitive review, i.e., to engage in unlimited differential pricing without regard to the costs actually incurred in each region, *Williams*, *supra*, clearly rejects this theory, as do the ICC and Surface Transportation Board decisions cited in the order.[112]

Finally, to the extent that AOPL and SFPP argue that Congress and the Commission have recognized that the oil pipeline industry faces a considerable degree of competition and that this should change the result here, this argument is simply not relevant. It is clear on this record that SFPP is the only product pipeline serving Arizona from points in Texas and California, and that railroads, barges or trucks do not provide competitive transportation of petroleum products to points in Arizona from El Paso or Los Angeles.[113] To the extent that the presence of competition might limit the application of cost-of- service regulation in the instant proceeding, the presence of competition has not been established here. The ALJ correctly determined the valuation of SFPP's rates and charges must be done separately for the West and East Lines. The related allocation issues are discussed in the rest of this section.[114]

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[112] *Williams*, 84 FERC at 61,103-104.

[113] This point is discussed by the ALJ in evaluating SFPP's business risk, but is equally applicable to the matter of competition. See 80 FERC at 65,145-46.

[114] SFPP does not assert that costs associated with those lines operating between southern California and the Pacific northwest should be included in the instant cost of service.

2. Between Jurisdictional and Non-Jurisdictional Operations.

Regardless of what maximum rate theory is adopted here, the parties agree that SFPP's jurisdictional revenues and costs should be separated from its non-jurisdictional revenues and costs. They disagree, however, over how this separation should be performed. Some of the matters raised in this regard are not before the Commission given its earlier determination that the complainants have not established that there are substantially changed circumstances to the basis for SFPP's West Line rates. These latter issues include the allocation of costs between inter- and intra-state operations in California,[115] the allocation of overhead costs between carrier and non-carrier operations to the extent that operations involve non-carrier facilities serving only the West Line shippers, and any cost issues related to the CalNev service. However, to the extent that facilities serve only the East Line shippers or both East and West Line shippers, then an allocation must be performed. Among the overhead costs at issue here are those of breakout tanks, the portions of terminals used for storing product for local delivery, and the related racks and other facilities that are used to transfer product from SFPP's system to a local pipeline, consumer, or transportation company, such as a trucking company.[116]

The ALJ concluded that the allocation of indirect overhead costs among SFPP's jurisdictional and non-jurisdictional South System operations should be based on the KN method. The KN method allocates indirect overhead costs based on the

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[115] See 80 FERC at 65,149-50.

[116] See 80 FERC at 65,118.

ratio of direct labor and capital investment of each of the pipeline's functions or services at issue to the total direct labor and capital investment of all of the divisions involved.[117] The ALJ found that an alternative method proposed by SFPP was not credible because it was based on the allocations used in SFPP's general ledger entries. These allocations were developed in an internal management study conducted in 1991 and used a strikingly uniform allocation factor for individuals with same or similar job descriptions without any variation by geographic location. As such, the ALJ concluded that by allocating some 83.5 percent of indirect costs to jurisdictional activities, SFPP's ledger based methodology did not adequately account for the fact that non-jurisdictional facilities on the South Lines accounted for some 25 percent of investment costs and 30 percent of direct labor. The ALJ also rejected a supporting study by Ernst & Young that reviewed SFPP's internal study, which concluded that 83 to 87 percent of joint costs were properly allocated to jurisdictional activities. Under the KN method 77 percent of the indirect overhead costs would be allocated to jurisdictional activities. The ALJ further concluded that the SFPP study was also inadequate because it was not introduced into evidence.[118]

On exceptions, the complainants and the Staff support the ALJ, asserting that SFPP's internal study was prepared in anticipation of litigation, and as such has little credibility. They also assert that it is unreasonable given some of the

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[117] *Kansas-Nebraska Natural Gas Company*, 53 FPC 1691 (1975), *aff'd* 534 F.2d 227 (10th Cir. 1976); *Mojave Pipeline Company*, 83 FERC ¶ 61,257 (1998). The method is applied only to costs that can be identified as direct overhead costs and that are allocated to the relevant division or function.

[118] 80 FERC at 65,148.

discrepancies that were uncovered and that the Ernst & Young study did not verify the internal SFPP effort by reviewing all the relevant workpapers. SFPP asserts that the ALJ erred in his ruling, and argues that the KN method has heretofore been used only in gas cases, and that in any event it is used only where more precise evidence of how indirect overhead costs should be allocated has been considered. SFPP again asserts that its ledger values were based on interviews of the staff involved at particular sites to determine the direct and indirect labor costs involved at those sites, and that the Ernst & Young analysis validated its integrity. Finally, it asserts that the actual workpapers were made available to all the complainant parties, and if reviewed, would support SFPP's conclusions.

This issue presented here is a difficult one since the allocation of indirect overhead costs by a more precise study is to be preferred over the use of a general regulatory formula. However, the party advancing a method that it believes is more precise has the obligation to establish that the method it proposes is preferable to the method normally applied under Commission policy.[119] The Commission concludes that SFPP has failed its burden in this regard. The uniformity in the overhead factors for each category of employee involved in both jurisdictional and non-jurisdictional operations without regard to the location or size of the facility or the scope of the territory covered supports the ALJ's conclusion that SFPP's internal accounting system cannot be relied on to support the allocations it has made. In particular, the Commission is troubled that such a high percentage of indirect costs was allocated to jurisdictional activities when it is undisputed on this record that some 30 percent of direct labor costs and 25 percent of

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[119] See *Exxon Corporation, et al. v. FERC*, 114 F.3rd 1252 D.C. Cir. 1997).

capital investment were attributable therefore to the non-jurisdictional activities. The Commission affirms the ALJ.

3. Among Various Portions of the South System.

Since the Commission has previously rejected SFPP's assertions that the South System should be treated as a single entity for ratemaking purposes, it is necessary to allocate costs among the different geographic sections of SFPP's South System. Such an allocation involves both the costs of facilities that are used by both the East and the West Lines to deliver petroleum products to points in Arizona as well as the allocation of indirect overhead costs between the two different services. SFPP allocated the common costs for facilities operated in Arizona based on the relative volumes moving in each direction during each month of the test year. The ALJ adopted this approach and it is not challenged here.

However the ALJ rejected SFPP's proposed allocation of indirect overhead costs between the East and West Lines. SFPP proposed to use a modified Massachusetts formula using three factors: direct labor, capital investment, and barrel-miles, the latter being a substitute for the revenue component normally used in Massachusetts formula.[120] The Commission Staff used a similar approach. In adopting the KN formula, the ALJ based his decision in part on an assertion that the Massachusetts formula is not used when the parent company has revenues.[121] The complainant parties

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[120] 80 FERC at 65,147.

[121] Citing *Questar Pipeline Company*, 74 FERC 61,126 at 61,455 (1996).

supported the ALJ while SFPP opposed this conclusion, arguing the formula that incorporated revenue was more appropriate.

On review, the Commission affirms the ALJ's adoption of the KN methodology but will modify his ruling. The Commission notes first that the choice of the KN or the Massachusetts method does not turn on whether a parent company has revenues or no revenues, the basis for the ALJ's ruling here. Rather, it turns primarily on whether separate affiliated corporate entities are involved in the allocation of common overhead costs, or whether functions or services involve the same legal entity. This central distinction was explained in *Mojave Pipeline Company*,[122] in which the Commission distinguished the *Questar* decision cited by the ALJ. In the instant case, since affiliates are not involved, the proper allocation method is KN. In fact, in *Mojave*, the Commission explicitly recognized that different services could be involved in the use of this formula. The formula is for different operations within the same company because the Commission has concluded that the limited number of overhead costs that cannot be directly assigned are best allocated on the basis of direct labor and capital costs that reflect the operations of geographically distinct portions of a pipeline's system. Thus, in the instant case, the East and West Lines are subsets of the same functional classifications, whose costs are allocated primarily on the engineering (capital) and labor of the assets involved. As such, it is appropriate to apply the same allocation method to the subset of a category as is applied to the category as a whole. The

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[122] 81 FERC ¶ 61,150 (1997), *reh'g denied*, 83 FERC ¶ 61,276 (1998).

ALJ is affirmed on his conclusion but reversed on his reasoning.

4. Military Costs and Revenue Crediting.

In addition to serving its conventional commercial markets, SFPP provides services to military facilities under section 22 of the ICA. Section 22 rates are negotiated rates between the United States and a private company for common carrier transportation services. Such rates are not subject to the Commission's maximum rate jurisdiction. In preparing its rate design for this case, SFPP excluded the costs of those facilities that were exclusively used to serve its military customers and the revenues that were generated exclusively by those facilities. It included in its cost of service that portion of military shipments that moved over its commercial trunkline system as part of its projected volumes, along with all costs attributed to those facilities. The ALJ accepted the exclusion of the costs of the spur that constitutes the military facilities but included all of the revenues generated by the military shipments, including the trunkline revenues, in the cost of service.

Several parties asserted that the ALJ's ruling raises both a cost allocation issue and a volumes issue. Staff proposed an alternative method which would simply credit military revenues against SFPP's total cost of service without excluding the costs that could be directly assigned to the military facilities. Chevron and Navajo requested that the Commission clarify that the KN method previously discussed will apply to the military facilities. In its reply, SFPP stated its methodology excluded all of the costs of the assets that served only the military facilities and the section 22 rates used to serve those facilities. It asserts that, from the point of origin to the point of connection to the military facility, SFPP

charges the standard commercial rate. Thus, it claims, the Section 22 rate is relevant only to those facilities that are used exclusively in military service. Finally, it supports the ALJ's conclusion that the indirect overhead costs associated with the military movements are removed at the same time the direct costs are under the KN method.

The Commission agrees with the parties that the ALJ mismatched trunkline revenues with the costs solely related to the military facilities SFPP was serving. SFPP correctly separated all the costs related solely to the military facilities and charged an incremental rate that was applicable solely to those facilities. Under these circumstances, the revenues derived from using the commercial rate to the point of interconnect with the military facilities have no relationship to the costs incurred only by the military facilities. Therefore there is no need to exclude the trunkline revenues paid by military customers as proposed by Staff, and the ALJ is reversed on this point. His conclusion regarding the allocation of the indirect overhead costs is affirmed on the grounds stated.

C. Cost of Service Issues

1. The Test Year for this Proceeding.

The ALJ held that 1994 should be the test year to be utilized in this proceeding. After initially reviewing 1993 as the test year, he determined that 1994 would be a more representative year, particularly for throughput, and permitted the parties to update the record with adjusted 1993 costs to develop 1994 operating expenses.[123] On exceptions, SFPP

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[123] 84 FERC at 65,123.

states that it does not object to use of 1993 as a base year but objects to the selective use of 1994 figures as the basis for the alternative year. It states that whatever year is used, the result should be a consistent matching of cost and revenues for the same years. SFPP asserts that the initial decision erred in selectively updating certain expenses and accounts from 1993 to1994 while not updating all of them, including the failure to update for fuel costs and to consistently use 1994 volumes as the basis for allocating costs. SFPP reserves the right to use actual 1994 right of way costs in making any compliance filing.

Two of the complainants assert that the use of a two-year test period is consistent with Commission practice, citing *Lakehead*. They also assert that use of an update is consistent with the Commission's current oil pipeline regulations and would result in a test year that is consistent with the December 31, 1994 date that is now used as the basis of the Commission's indexing methodology for evaluating rate filings after that date. They assert in general that there was little variation in SFPP's operating costs from 1993 through 1994 and that the ALJ's methodology was reasonable and should be affirmed. Chevron asserts that regarding SFPP expenses for leasing its right-of- way, SFPP admits that it did not use the 1994 right-of-way expense information that Chevron's witness found to be unreliable. Chevron claims that the 1994 property additions, retirements, transfers, and other adjustments were not a credible basis for adjusting SFPP's 1993 cost of service, and that in any event, the use of costs for the entire year 1994 would extend beyond the nine month known and measurable period contemplated by the Commission's regulations.

The Commission first affirms the ALJ's ruling to use 1994 as the base year in this proceeding. Since the Commission

has determined that the West Line Shippers have not proven substantially changed circumstances, only the East Line rates are now at issue, and the ALJ correctly decided that 1994 is a more representative year than 1993 for volumes on that line. However, SFPP is correct that 1994 costs should have been used to the extent possible in developing SFPP's cost of service for that year. As argued by Chevron on exceptions, there may be some limitations in the quality of SFPP's accounting data for that particular year, for example, in the additions and retirements made to its plant in 1994. However, these fairly narrow technical issues can be addressed in a compliance filing through a review of the company's work papers and the final entries for SFPP's accounts for the calender year 1994.

2. Rate Base Issues.

Under Opinion No. 154-B oil pipelines use a rate base and depreciation method based on trended original cost (TOC). The method is similar in most regards to the net depreciated original cost method (DOC) used in gas pipeline regulation. However, inflation is accounted for in a different manner. Under the DOC method, an inflation factor is included in the equity cost of capital and is expected to be recovered from current earnings. Under the TOC method, the inflation component of the equity cost of capital is added to rate base, an addition called the deferred equity component of the rate base. The deferred equity component is then amortized over the remaining life of the current year's addition. The result is lower rates in earlier years of an investment, which makes it easier for new entrants, or new investment, to compete with older investment. Returns are lower in the initial years under this method but the present value of the total returns over the

operating life of the pipeline are expected to be approximately the same under either method.[124]

Oil pipelines also have a different method for establishing the rate base. Gas pipelines utilize a original cost based method that reflects actual additions and retirements to the pipeline's plant accounts determined in accordance with the Commission's Uniform System of Accounts. Prior to June 28, 1985, oil pipeline rate bases were based on an Interstate Commerce Commission reproduction cost valuation method that significantly increased oil pipeline assets when compared to the book basis of the same assets.[125] Upon the adoption of the Opinion No. 154-B rate methodology on June 28, 1985, the issue of the relationship between original cost and the ICC's valuation method was revisited. The Commission decided to adopt an original cost methodology but tempered this conclusion with a device designed to mitigate the transition to the new method of determining a pipeline's rate base.

Recognizing that an abrupt change to an original cost-based method would reduce oil pipeline earnings and have a potentially sharp impact on oil pipeline investors, the Commission developed a transitional, middle ground method

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[124] *Williams Pipe Line Company*, Opinion No. 154-B, 31 FERC ¶ 61,377 at 61,834-35 (1985).

[125] The ICC valuation formula appears in *Williams Pipe Line Company*, 21 FERC ¶ 61,260 at 61,696, footnote 295 (1982), and *Farmers Union Central Exchange, Inc. v. FERC*, 734 F.2d 14886, at 1495 footnote 28 (D.C. Cir. 1984), *cert denied,* sub. no. *Williams Pipe Line Co. V. Farmers Union Central Exchange, Inc.*, 469 U.S. 1034 (*Farmers Union*). *See also Kuparuk Transportation Company*, 55 FERC ¶ 61,122 at 61,364 (1991).

that is fair in light of investor expectations, but did not perpetuate the serious flaws of the previous method. The compromise method employs a starting rate base (SRB) that is the sum of a pipeline s debt ratio times net depreciated original cost and the equity ratio times the reproduction portion of the valuation rate base depreciated by the same percentage as the original cost rate base had been depreciated.[126] The size of the SRB is therefore strongly affected by the pipeline's debt/equity ratio. Calculation and amortization of the SRB and any deferred equity components of the rate base are among the issues raised here. In addition, oil pipelines are permitted to add Allowances for Funds Used During Construction (AFDUC) to new plant additions after December 31, 1983, and are required to consider related Accumulated Deferred Income Taxes (ADIT) in determining rate base.[127]

a. The ALJ's Determinations.

The ALJ first determined that SFPP's starting rate base should be determined in part by adopting SFPP's actual capital structure as of December 19, 1988, when it first became a publicly traded partnership pursuant to a corporate reorganization by its parent company, the Santa Fe Pacific Corporation, and that the deferred equity component of the rate base up to December 18, 1988 also should be determined using SFPP s December 19, 1988 capital structure.[128] He also determined that the SRB should be amortized based on the remaining useful life of SFPP's assets as of December 31,

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[126] Opinion No. 154-B at 61,836.

[127] *Id.* at 61,234-36.

[128] 80 FERC at 65,130-31.

1983, the point from which the Commission's trended original cost methodology was to be applied to a pipeline's existing asset base.[129] He further concluded that the equity component of the SRB after December 19, 1988, and the deferred equity component of the additions to the rate base after the same date should be governed by the capital structure applicable to the year of the addition, and that the actual inflation rate in the test year should be used for determining the increase in the deferred equity component.[130] The ALJ also held that SFPP had not used an appropriate method for amortizing its ADIT and had not justified its proposed AFUDC.[131] The ALJ therefore adopted an alternative method for determining AFUDC and modified SFPP's proposed method for recognizing these costs. The ALJ also rejected arguments that SFPP should be required to adjust the amount of accumulated depreciation on its books.[132] All of theses rulings are contested on exceptions.

b. The Starting Rate Base.

As discussed, the SRB of an oil pipeline reflects the compromise rate base methodology adopted by the Commission on June 29, 1985 when it issued Opinion No. 154-B. The issues involved here include determining the SRB,

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[129] 80 FERC at 65,134, citing Opinion No. 154-B, 31 FERC ¶ 62,377 at 61,839, n.40 (1985). December 31, 1983, was the end of an annual valuation under the Commission's regulations.

[130] 80 FERC at 65,135.

[131] 80 FERC at 61,140.

[132] 80 FERC at 65,141.

the equity and debt components of the capital structure, and the amortization of the SRB once it has been created.

The first issue is how to determine the SRB for the South Lines. As has been discussed, as of December 31, 1983 there were two different sets of numbers, using the pipeline's historical cost and the valuation base developed under the ICC methodology. In the instant case, Staff examined the historical cost of the South Lines and determined the ratio of net depreciated original cost of the South Lines to the net depreciated original cost for the system as a whole. Staff then applied this ratio to the total ICC valuation base to determine the valuation figure to be use to for the South Lines.[133] SFPP presented an alternative method that utilized 1993 volumes to determine how the 1983 SRB costs should be allocated to the South System.

The Commission finds that staff's approach was the more reasonable of the two approaches and should be adopted because consistent with the Opinion No. 154-B methodology, it factors in the net accumulated depreciation for determining the historical rate base, just as accumulated depreciation is used in adjusting the valuation base. The ALJ correctly relied on Staff's ratio method for determining the allocation of the SRB costs between the North and South Lines and properly rejected SFPP's methodology.[134]

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[133] See 80 FERC at 65,129, footnotes 132 and 133.

[134] Since only the East Line rates are at issue here, it will be necessary to divide the South Line rate base between the East and West Lines, reflecting the fact that one line between Phoenix and Tucson is used for east bound service and one for west bound service. The ALJ did not address this issue in his order and therefore the parties will be required to do so when SFPP makes its

c. The Capital Structure to be Applied in Determining the SRB.

As the ALJ correctly stated, the next step is to determine the debt and equity portions of the SRB. This is done by multiplying the debt ratio times net depreciated original cost of the pipeline's assets and multiplying the equity ratio times the reproduction portion of the valuation rate base after it is depreciated by the same percentage as the book original cost rate base has been depreciated. Opinion No. 154-B states in categorical terms that the pipeline will use its actual capital structure, or if the pipeline s capital structure is not representative, the capital structure of its parent.[135] In either case, for pipelines with a valuation rate base as of December 31, 1983, the capital structure to be used is that as of June 28, 1985, because that date is the date of transition to the trended original cost methodology.[136]

In the instant case, SFPP had no independent capital structure as of that date; therefore, its parent company's capital structure would normally be used under the guidance contained in Opinion No. 154-B. However, on June 28,

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compliance filing.

[135] Opinion No. 154-B, 31 FERC at 61,836. The Commission noted in *Kuparuk*, *supra*, "the strong preference for the use of the parent company's capital structure if the parent guarantees the oil pipeline's debt." 55 FERC at 61,377. While no debt is involved here, the principle is the same.

[136] Opinion No. 351-A at p. 62,384, footnote 8.

1985,[137] SFPP's parent, Santa Fe Pacific, had an unusual equity-oriented capital structure, with equity comprising 78.29 percent of the capital structure and debt 21.71 percent of the capital structure.[138] Based in part on this weighting, the ALJ concluded that the risks facing SFPP's parent company were different from those of SFPP itself and that the use of the parent's capital structure would be inappropriate.[139] The ALJ therefore concluded that a more representative capital structure would be that adopted by SFPP when it became a publicly traded limited partnership on December 19, 1988.[140] At that time, SFPP's capital structure was changed, through the issuance of debt instruments, to approximately 60.74 percent debt and 39.26 percent equity.[141] He therefore adopted a hypothetical capital structure for the period between December 31, 1983, and December 19, 1988 using that ratio, and ruled that SFPP should use its actual book capital structure for the period after December 31, 1988.

The Staff and the complainants support the ALJ's decision, based on the ALJ's ruling in a 1987 initial decision[142] that SFPP's parent had different risks because most of its operations were unregulated and the parent was far

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[137] Opinion No. 154-C provides that the capital structure for the SRB shall be determined as of the date of that opinion. 33 FERC at 61,640.

[138] 80 FERC at 61,126.

[139] 80 FERC 65,128-29.

[140] *Id.*

[141] 80 FERC at 65,130.

[142] *Southern Pacific Pipe Lines, Inc.* 39 FERC ¶ 63,018 (1987).

more heavily involved in rail and trucking than in pipeline operations.[143] Staff also argues that in its previous rate case SFPP itself asserted that the parent's capital structure was inappropriate. SFPP argues that the ALJ's ruling would require it to change its capital structure retroactively at a time when the company had no time to respond by modifying its capital structure, and asserts that in any event that there is no evidence on this record that SFPP's risks for the period before December 18, 1988, were different from its parent's.[144]

In addition, SFPP asserts that the SRB should not be modified to reflect the change in capital structure that occurred on December 19, 1988, but that the SRB should reflect the capital structure used to create it until the SRB is fully amortized. Otherwise, it asserts that the SRB will not be "frozen." On this point the Staff and complainants also support the ALJ, asserting that there is no indication that Opinion No. 154-B intended the capital structure to be static and that later decisions specifically contemplated that the pipeline's capital structure would change. Under SFPP's theory, the initial amount of the SRB is fixed and would change only through the amortization of the SRB. Under the ALJ's approach, the debt-equity ratio of the SRB would vary depending on the debt-equity ratio adopted in subsequent rate cases as it does in gas proceedings.

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[143] 80 FERC at 65,128.

[144] On the latter point SFPP is correct. The only material cited is the holding by the ALJ in SFPP's prior rate proceeding that the risks of SFPP and its parent between 1985 and 1988 were not similar. Staff also asserts that in the same period, SFPP itself asserted that its parent's capital structure should not be used. However, SFPP was arguing for a 100 percent equity capital structure.

Both the complainants and SFPP argue at length the circumstances under which the Commission has required a hypothetical capital structure, and whether it fails to create a middle ground result in creating the rate base called for by the SRB methodology. This concerns a dispute whether the Commission's description of the SRB in Opinion No. 154-B as a "middle ground" refers to a methodological middle ground or a statistical "middle ground" between the historical rate base and the ICC valuation method.[145] Without reaching this issue, the Commission concludes that capital structure in the instant case should be the capital structure of SFPP's parent as of June 28, 1985. It does so on the grounds that the issue of whether a hypothetical structure should apply to the period December 31, 1983 through December 19, 1988 is foreclosed by the 1988 settlement between SFPP and most of its principal customers.[146]

In the 1988 settlement, the parties agreed to modify, and substantially reduce, SFPP's rates and to provide for subsequent increases that would reflect additional capital expenditures that SFPP proposed to make to its system. Approval of a settlement establishes a legal just and reasonable rate that the carrier may utilize until the rate is changed by a subsequent filing or by action on a complaint. While the Commission did not address each element that lay behind the settlement rates, and as such did not make an explicit determination that capital structure of SFPP's parent was just and reasonable as of June 30, 1985, the issue was addressed by the ALJ's decision and was before the parties at the time the 1988 settlement was filed. Moreover, the nature

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[145] See 80 FERC at 65,129 for the ALJ's discussion.

[146] See 45 FERC ¶ 61,242 (1988).

of the Opinion No. 154-B methodology was known and the potential impact of SFPP's capital structure on its rates could be readily calculated by the parties. The parties clearly elected to reduce SFPP's rates at when the 1988 settlement became effective, but do not appear to have addressed the issue of SFPP's capital structure at that time, essentially leaving it in place. It was modified shortly thereafter.[147]

This case is a complaint, not a suspension proceeding, and it would be unreasonable to change retroactively SFPP's capital structure to ante-date the July 6, 1988 settlement that established SFPP's rates for the five years after November 23, 1988. This latter date was less than one month before SFPP recapitalized its system and modified its debt-equity ratio to approximately 60 percent debt and 40 percent equity on December 19, 1988. The issue of SFPP's capital structure was one that the parties could have disposed of in the context of the 1988 settlement if the issue was one of import to the settling parties. They declined to do so. Moreover, on December 31, 1983, SFPP's existing facilities had a composite remaining useful life of approximately 20.6 years. Since over 15 years will have passed between the date of the SRB and the effective date of any East Line rates to be adopted in this proceeding, the amount of the SRB will have been sharply reduced, as well as its impact on the rates to be set here.[148]

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[147] See the text of the January 30, 1989 Stipulation and Agreement between SFPP, Inc. and Navajo included in Exh. 895.

[148] The Commission notes that the decision here does not condone a capital structure with an equity component of 79 percent; only that the procedural framework is such that no further discussion or action is warranted.

It is also essential to distinguish between the capital structure to be applied to the SRB and that to be applied to later changes to the pipeline's investment base. First, SFPP is correct that the capital ratio applied to the SRB at the time it is created should apply to the SRB until it is fully amortized. The Commission intended that the SRB be a transitional method designed to mitigate the change to its current TOC methodology for holders of oil pipeline equities on December 31, 1983. To modify the SRB to reflect changes to a capital structure that occurred after the SRB was defined would modify the expectations of the equity holders and defeat that purpose. While the Commission stated that some oil pipelines may not be entitled to use the SRB method, this comment did not go to the makeup of the SRB if the method was otherwise available. Therefore, the structure the Commission has determined is appropriate for the SRB as of December 31, 1983, will apply to the SRB until it is fully amortized.[149]

d. Amortization of the SRB.

The next issue involves the amortization of the SRB after its calculation as of December 31, 1983.[150] The arguments of

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[149] The Commission is making other rulings, infra, that will lessen the impact of this decision, for example, those regarding SFPP's capital structure after December 18, 1988, and the method for amortizing the deferred equity component of any additions to the rate base after December 31, 1983.

[150] Opinion No. 351 concluded that pipelines are not entitled to amortize the write-up in starting rate base as a cost-of-service expense. The shift from a valuation to a TOC methodology does not transform the write-up of SRB into deferred earnings or any other expense. The starting rate base was adopted for the purpose

the parties on this point turn on whether the SRB should be amortized by varying the amortization period to reflect changes to the estimated useful life of the pipeline's assets that occur in years when additions or retirements are made to its property accounts. SFPP's proposed method, called the "variable method" by the ALJ, has the practical effect of extending the amortization of the SRB, because the remaining useful life of the pipeline is extended as additions to its rate base lengthen its composite depreciation rate. The ALJ rejected SFPP's method in favor of a constant rate of amortization based on the composite depreciation rate in effect on December 31, 1983. SFPP excepts to this ruling, which the other parties support it.

The ALJ is affirmed on this point. As the ALJ stated, the SRB is a one-time calculation that is designed to operate as a transitional mechanism that will gradually return the pipeline to a purely original cost-based rate base, as properly determined under the TOC method. Any additions to the SRB, or a method for calculating it that extend its amortization period beyond the composite useful life of the pipeline's assets as of December 31, 1983, are inconsistent with the concept of an adjustment mechanism. Therefore, the proper way to amortize the SRB is over the composite remaining useful life of the pipeline's assets as of December 31, 1983, which in this case was approximately 20.6 years.

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of determining return on and not return of capital. The write-up is a transitional measure which should be decreased over time. *See ARCO Pipe Line Company*, 53 FERC ¶ 61,398 at 62,386.

e. Calculation of the Deferred Equity Component.

As has been noted, once the SRB is determined, all additions to the rate base are at original cost. Additionally, under TOC, the inflation component of the equity portion of the new investment is added to rate base as a deferred equity return. Thus, if the equity cost of capital is 12 percent, the inflation component is 10 percent, and the investment $100, then $10 of the return is deferred in the first year. Amortization of this deferred return begins in the first year of the investment and continues over the life of the additional property. The disputes here center on the capital structure to be used in determining the deferred equity component of rate base, the inflation rate to be used to determine the deferred equity return, and the proper method for amortizing the deferred equity return.

The ALJ first rejected in part SFPP's argument that the capital structure for calculating the deferred portion of the equity return should be the actual capital structure in any given year in which a deferred equity component is determined. For the years between January 1, 1984, and December 18, 1988, the ALJ used the same imputed capital structure based on SFPP's actual capital structure as of December 18, 1988. Thereafter, he stated that the actual debt equity structure should be used to determine the portion of the inflation component that should be deferred in each year. The complainants and the Staff support the ALJ.

The Commission reverses the ALJ on the capital structure to be used to calculate the deferred equity component between January 1, 1984 and December 18, 1988, for the same reasons supporting the ruling on the capital structure to be used to defend the SRB. Thus, the actual capital structure of SFPP's parent should be used for the period December 31,

1983 to December 18, 1988. As in the case of the SRB, this results in an unusually high equity component for those years. However, since the largest portion of the West Line and East Line construction was placed in service after December 18, 1988, this will mitigate the impact of the four years of a high equity component on SFPP's current rates.

After December 18, 1988, SFPP's actual capital structure in any given year should also be used in determining the portion of the equity component that is to be deferred in each year. In any such year, the equity component of the pipeline's capital structure reflects the cost of equity and the risk involved in the year that the investment is made, and as such is the appropriate basis for determining how much of the total return will be capitalized and amortized under the TOC methodology.

Since the deferred equity component accrues, this will, as the ALJ and the complainants assert, shift the capital structure toward the equity portion, at least until the deferred equity component begins to decline through its amortization. However, the debt/equity ratio used to define the portion of a deferred equity component of a given fiscal year's investment should not change in subsequent years, nor should the inflation component. SFPP appears to have adjusted the subsequent deferrals of the investment made in a given year to reflect changes in the capital structure and the inflation rate that occur in future years, a so-called layering approach. The ALJ correctly rejected this approach. The only debt/equity ratio and inflation rate that are relevant to a given stream of deferrals are those for the year in which the investments are made. Subsequent years are irrelevant to the risk evaluation the pipeline made when deciding to make an investment.

A second, more narrow point in calculating the deferred equity component is the inflation rate to be used to determine the portion of the equity cost of capital that should be capitalized. The ALJ correctly concluded that this should be the actual inflation rate in the year in which the investment is made. This calculation has been derived from an extrinsic historical source, the annual consumer inflation index,[151] and is used to determine the inflation component of the equity cost of capital. The ALJ is affirmed for the reasons stated in his order.

A third point is how the deferred equity return should be amortized. One method would be to have a separate amortization period for the deferred equity component of each increment to the pipeline's rate base, and to amortize that increment through a constant amortization rate based on the composite depreciation rate for the year any additions are made. This provides a clear time frame within which the deferred equity component caused by each year's investment will be amortized. An alternative method is to combine the equity deferrals from different years into a single pool, and to modify the amortization period to reflect changes in the pipeline's estimated useful life as that life varies based on the changes that occur to its investment base. This latter method is characterized as a "variable" approach of amortizing the deferred equity component of the rate base, and has the effect of extending the amortization period of any deferrals. The

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[151] For example, see Economic Indicators Prepared for the Joint Economic Committee by the Council of Economic Advisers, December 1995 (GPO 1995), page 24, Changes in Consumer Prices, All Urban Consumers, far right column showing ten years of annual price changes 1985 through 1994.

ALJ rejected the variable method, consistent with his ruling that the SRB should be amortized at a constant rate.

The Commission affirms the ALJ on the amortization issue with the following clarification. The amortization of the deferred equity return is to be done annually as follows. Amortization of the deferred component of the equity return begins in the year in which that inflation component is deferred. Consistent with the previous determination on how the deferred equity return is calculated in subsequent years, the composite depreciation rate for the year in which the return is first deferred will be used to amortize that deferred return in all subsequent years until the amortization is completed. This will assure that the deferred return is amortized in a reasonable period of time and prevent its indefinite extension.

f. Accumulated Deferred Income Taxes.

SFPP calculates its income tax allowance using the normalization method i.e., in essence income taxes are imputed on the allowed equity return. Under that method, temporary differences between the amount of taxes computed for ratemaking purposes and taxes on the amount of actual current federal income liability are accumulated as deferred income tax liabilities (ADIT). For example, SFPP initially accelerates its depreciation expense for tax purposes, but computes its tax expense for rate purposes as if it were paying the higher taxes reflected by its book depreciation method (such as straight-line). As a result SFPP collects through current rates funds necessary to pay both its current and

deferred tax liability.[152] Later, when the depreciation expense amounts reverse so that taxable income is higher than book (rate) income because depreciation as a tax expense is less than depreciation as a book (rate) expense, SFPP will use its ADIT to pay its higher tax liability. In the interim, the ADIT are deducted from the pipeline's rate base to ensure that shippers do not pay a return on cost-free deferred tax capital.

The ALJ addressed several issues related to SFPP's calculations of its ADIT. The first is the proper method for amortizing the excess or deficiency of ADIT for each category of property resulting from changes in income tax rates. SFPP proposes a method that aggregates all the ADIT balances for all categories and for all vintage years into a single pool, and amortizes the pool using a variable remaining life method. The ALJ concluded that this results in an extension of the amortization period long after the time when the assets on which the balance accrued have been depreciated and retired from service. In contrast, the complainants used a method that conforms to the Commission's South Georgia method.[153] Complainants propose to amortize the overfunded or underfunded ADIT balances for each category and vintage of property over the remaining life of that category and vintage. The Commission has long accepted the use of the South Georgia method as a reasonable way of dealing with the

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[152] At any point in time, the ADIT balance reflects the amount by which the cumulative income tax allowance included in the pipeline's cost of service exceeds the cumulative income tax liability of the pipeline. Ex. 365 at p. 20.

[153] See *Natural Gas Pipeline Company of America*, 13 FERC ¶ 61,266, at pp. 61,587-88 (1980); *see also Natural Gas Pipeline Co. of America*, 26 FERC ¶ 61,047, at p. 61,149 n.3 (1984). Exh. 365 at p. 22; Tr. 3618-19.

problem of over or under-funded deferred taxes. SFPP's proposed method has not been shown to be preferable. Therefore, the Commission affirms the ALJ's decision to adopt the conventional South Georgia method.

The second issue concerns the amount of "unfunded" tax liability that SFPP should recover. This issue has its genesis in 1974, when SFPP's predecessor, SPPL, adopted the normalization method of accounting and established ADIT. Because the ICC had required SPPL to use "flow through" prior to 1974, SPPL had not recovered this ADIT from its shippers, i.e., it was "unfunded". There is no dispute that SFPP is entitled to recover that unfunded balance. The dispute centers around when to begin amortizing this unfunded ADIT: in 1974, when SPPL adopted normalization, or in 1984, the effective date of Opinion No. 154- B. SFPP argues that the Commission adopted normalization as the standard for oil pipeline ratemaking in Opinion No. 154-B. Choosing 1974, as complainants urge, would result in a lower rate base and income tax allowance, whereas choosing 1984, as SFPP advocates, would increase SFPP's rate base and income tax allowance. The ALJ rejected SFPP's approach, finding it inconsistent with SFPP's adoption of normalization for accounting purposes in 1974.

The Commission affirms the ALJ's ruling on this issue but on a different basis. Although no party contests SFPP's right to recover the unfunded ADIT, the Commission concludes that SFPP has failed to show that it has not already recovered the portion of the unfunded ADIT that should have been amortized since 1974. It is reasonable to assume that SFPP would not have adopted normalization for accounting purposes absent corresponding rate recovery of a normalized tax allowance. To do otherwise would expose SFPP to under-recovery of its normalized tax expense after 1974. But

SFPP seeks only to recover unfunded ADIT that existed prior to 1974. This implies that its rates after 1974 were normalized. However, it is impossible to determine from the record whether SFPP's post-1974 rates included amortization of the unfunded ADIT, but it is logical to assume that the rates were sufficiently high to amortize the deferred cost; otherwise SFPP would have acted against its own interest.[154] Therefore the Commission rejects SFPP's proposal to begin amortization (i.e., rate recovery) of its unfunded ADIT in 1984, and requires SFPP to begin amortizing its unfunded ADIT beginning in 1974.

Finally, there are two ADIT issues related to SFPP's partnership status. First, under the Commission's *Lakehead* decision,[155] partnership pipelines are permitted to include an income tax allowance in their rates only for that portion of enterprise that is owned by interests that incur a corporate income tax liability on their share of the partnership income. In the instant case, the ALJ ruled that to the extent SFPP had taken an income tax allowance in past years in violation of the *Lakehead* doctrine, that it must include such payments in its total ADIT. SFPP excepts to this and the other parties support the ALJ.

The Commission will resolve this issue on narrow grounds. As is explained below, the Commission is affirming that SFPP must apply the Lakehead doctrine in designing its rates, which will be based on a cost of service for the

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[154] The rate proceedings subsequent to SFPP's adoption of normalization concluded in settlements, which cannot be relied upon as support for the ratemaking treatment of any item.

[155] *Lakehead Pipe Line Company, Limited Partnership*, 71 FERC ¶ 61,338 (1995), *order on reh'g*, 75 FERC ¶ 61,181 (1996).

calender year 1994, and for all years thereafter. This is because Commission practice is to base its decision on the policy in effect in the year a regulatory decision is made, and then apply that decision to the time frame to which the case applies. For example, in *Lakehead*, the Commission applied the Lakehead policy, decided in June 1995, to the locked in period May 3, 1992 to July 5, 1993, in the context of a suspension proceeding.[156] The earliest complaints filed here were September 4, 1992. Given the similarity in the time frames and the issue, the Commission concludes that SFPP's rates should be determined in a similar fashion, and will apply *Lakehead* to this proceeding as of the date of complaints that are sustained in this proceeding. SFPP will not be required to apply *Lakehead* to periods before the actual date of any complaint investigated herein. Since the rate itself is to be adjusted, together with reparations as appropriate, there is no need for SFPP to create the additional ADIT required by the initial decision since the necessary adjustment will be reflected in any reparations awarded. The ALJ is reversed to that extent. The second issue is whether the ADIT balance that existed on December 18, 1988, when the pipeline was transformed from a corporation into a limited partnership, should be retained or eliminated. At the time the partnership was formed, SFPP, Inc., as a new limited and general partner, contributed assets to the partnership with a fair market value in excess of the tax basis of those assets. The difference between the assets' fair market value and its tax basis, i.e., the gain, would normally result in an immediately payable tax liability. However, when a partner contributes property to a partnership, the contributing partner is able to

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[156] 71 FERC at 62,305, footnote 1.

defer paying the tax on the gain to future years.[157] In Opinion No. 397-A, the Commission recognized that the tax on the gain that would be eventually be paid by the contributing partner is not includable in a pipeline's cost of service.[158] SFPP argues that the Commission should treat its ADIT in the same manner as it treats the tax on the gain (i.e., exclude the ADIT from the cost of service) because the ADIT is related to the gain on the sale.[159]

The Commission agrees with the ALJ's conclusion that the ADIT balance existing at the formation of the partnership should be retained. As the ALJ recognized, if no tax was payable by the partner at the time it contributed property to the partnership, there is no justification for eliminating SFPP's 1988 ADIT balance. The deferred taxes accumulated by the pipeline prior to its reorganization remain available to pay future income taxes, and, consistent with Commission policy, ratepayers are entitled to the full benefit of the ADIT deduction from rate base until those taxes are paid. Therefore, SFPP's ADIT balance existing at the time of the formation of SFPP in 1988 should be adjusted for changes in ADIT from 1989 through 1994, and deducted from the rate base in 1994.

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[157] No gain or loss is recognized upon a contribution of property to a partnership in exchange for a partnership interest. I.R.C. Section 721(a).

[158] 75 FERC ¶ 61,181 at 61,598-99 (1997).

[159] On December 18, 1988, SFPP's ADIT balance reflected, at last in part, the difference between the book basis and the tax basis of its properties.

g. AFUDC.

The Commission permits oil pipelines to add an allowance for funds used during construction (AFUDC) to the cost of plant additions for ratemaking purposes.[160] In essence, the allowance compensates the pipeline for the return that would otherwise be earned on funds that have been committed for utility purposes but have not yet been included in rate base. The determination of the amount of allowable AFUDC is a matter of import in this proceeding because of the large additions made by SFPP to its rate base in the late 1980's and early 1990's. It is uncontested that SFPP did not keep appropriate records on the monthly cash expenditures for each construction project for the years 1984 through the 1994 test year, or exclude from the AFUDC calculation interest on those portions of gross property additions that represent suspended or failed projects.[161]

To provide SFPP with at least some AFUDC, the ALJ accepted an AFUDC allowance based on the percentage that actual interest capitalized on SFPP's books (during 1989-1993) bore to the total interest that would have been capitalized using SFPP's cost of debt. He rejected an estimate developed by SFPP equal to one half of the interest that would have derived by applying SFPP's overall weighted cost of capital to its total capital expenditures for a three-year period, 1991 through 1993. He did so even though the amount permitted under the method he accepted was not adjusted for deferrals or incompletions, and did not, reflect

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[160] See *Kuparuk Transportation Company*, 55 FERC ¶ 61,122 at p. 61,372 (1991).

[161] 80 FERC at 65,139.

only eligible construction expenditures. The ALJ concluded that SFPP's estimate was not based on any formal record of interest that had actually been incurred, while the alternative he accepted was at least based on the actual interest amounts recorded on SFPP's books for a five year period.[162]

On exceptions the complainants and the Staff assert that SFPP should obtain no AFUDC or that its recovery should be limited to the lower figure adopted by the ALJ. SFPP asserts that its methodology was appropriate, claiming in part that the methodology it used to develop its estimate understates the actual IDC (interest during construction) that SFPP reported to the IRS in some years. SFPP argues in the alternative that it should obtain some AFUDC, and that the Commission should affirm the ALJ's ruling if the Commission's rejects SFPP's primary argument.

Determination of a reasonable AFUDC amount in this proceeding is difficult given SFPP's failure to maintain construction records in a manner reasonably consistent with FERC practice. AFUDC is a basic regulatory accounting concept, and is important here, considering the amount of money involved. While in Opinion No. 154-B the Commission did not require oil pipelines to use any particular method for calculating AFUDC, the regulatory concept and the principles to be applied were well established in numerous Commission cases and were later followed in major oil cases.[163] By failing to keep the proper records SFPP effectively undercut its own interests. However, the ALJ was

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[162] 80 FERC at 65,139-40.

[163] ARCO Pipe Line Company, 52 FERC ¶ 61,055 (Opinion No. 351) at 61,231-35 (1990), *order on reh'g*, 53 FERC ¶ 61,398 Opinion No. 351-B) (1990).

correct in concluding that a complete denial of AFUDC would be an inordinately harsh result.

The AFUDC methodology adopted by the ALJ, based on that used by Navajo's witness Zaegel,[164] results in a AFUDC allowance of 29.3 percent of the interest that would have been earned if SFPP's cost of debt were applied to 100 percent of gross plant additions. Thus, on $100 of gross plant additions, the AFDUC would be approximately 30 percent of a full year's interest on those capital expenditures. Thus, at a debt cost rate of 10 percent, the AFUDC allowable on those gross plant additions would be $3.00. He then applied this methodology to the capital expenditures for the East and West lines to arrive at an estimated AFUDC that should be used in designing those rates.

In contrast, SFPP's witness Ganz performed a calculation based on 50 percent of its "South System" capital additions. His calculation looked at total system-wide capital expenditures for the year, divided that number by half,[165] applied SFPP's overall weighted cost of capital to the result, and developed an estimated AFUDC. Thus, following the prior example, and assuming debt and overall cost of capital is the same, i.e., 10 percent, the cost of capital figure would be applied to one half of $100, or $50, resulting in a capitalized AFUDC of $5. SFPP then compared the interest that resulted from this calculation to the interest actually capitalized for income tax purposes as a test of its reasonableness.

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[164] See Exhs. 137 and 157.

[165] This calculation assumes that the average period for a project, including all allowable costs, is approximately one year and that the expenditures are distributed over the year on a roughly equal basis.

The problem with SFPP's calculations is SFPP failed to take any steps to tie them directly to actual expenditures on the South Lines or to derive the imputed AFUDC directly from the interest recorded on its books. The record suggests that Navajo's method may very well understate the AFUDC that SFPP would be entitled to if its records were maintained adequately. However, in the absence of any evidence much beyond assertions by the parties that their proffered method is correct, the Commission is left with the choice of affirming the ALJ and accepting Navajo's better supported, if understated, AFUDC calculation, or allowing none. The ALJ is affirmed.

h. The Amount of Accumulated Depreciation.

A final issue is the determination of the proper amount of accumulated depreciation that should be used in determining the net plant balance includable in rate base and in the determination of the proper equity balance to be used in determining the capital structure. At hearing one complainant, Navajo, asserted that SFPP improperly removed all the accumulated depreciation from its accounts when it reorganized into a partnership, a total of some $115 million, thereby increasing rate base and partner's capital. Navajo asserted during the hearing, and on exceptions, that since the equity component of SFPP's capital structure was increased, the equity return allowance is higher than would otherwise be the case if the accrued depreciation had not been eliminated. Navajo further asserts that another practical effect of this action is to require the rate payers to pay for the same assets twice. It therefore requests that SFPP be required to restate its accounts to include the accrued depreciation that it removed when the partnership was organized.

The ALJ concluded that there was insufficient evidence to warrant restoration of the accrued depreciation that SFPP eliminated from its balance sheet when the partnership was created on December 19, 1998. On exceptions, SFPP supports the ALJ's conclusion that the evidence is insufficient to require restoration of the accrued depreciation, that Navajo is the only party that raised the issue, that it did so only on cross-examination of one witness, and that in any event SFPP did not increase the value of its rate base to reflect the increased value of the assets contributed from the predecessor corporation to the limited partnership.

The issue raised by Navajo is a serious one. When SFPP succeeded to the ownership and operation of the pipeline on December 18, 1988, it closed its corporate books and later filed a Form No. 6 reflecting that fact. It also filed a separate Form No. 6 for the period December 19 to December 31, 1988.[166] A review of SFPP's Form No. 6 for the period December 19 to December 31, 1988, discloses a sharp increase (approximately $222.5 million) in the reported value of SFPP's net carrier property compared to that reported on December 18, 1988. The increase in SFPP's assets reflects not only the elimination of accumulated depreciation, but also a re-valuation of the book basis of carrier properties.[167] Re-valuations of SFPP's liabilities and/or adjustments of

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[166] A search of the Commission's public records discloses that SFPP did obtain permission from the Office of the Chief Accountant to file two different Form No. 6's for the calendar year 1988.

[167] According to a March 6, 1989 letter to the Commission's Chief Accountant, SFPP stepped-up the basis of its properties by approximately $125 million.

SFPP's equity balances necessarily would result from the re-valuations of SFPP's assets.

Although under the Commission's regulations the adjustment of assets at issue here may be permissible for accounting purposes,[168] the issue here is whether the adjustment was correct for ratemaking purposes. SFPP states that it did not attempt to write-up its rate base to reflect the sale of the corporate SFPP assets to the partnership. The Commission agrees that this statement is correct as far as it goes. In this proceeding, the Commission has determined the starting rate base as of the end of 1983, which was prior to the reorganization. Additions to rate base since 1983 were based on original cost (plus AFUDC and the deferred equity return). Therefore, the book amounts of re-valued assets did not enter into rate base determinations. However, equity balances used in determinations of capital structure and equity return in this proceeding would have reflected the effect of the asset re-valuations, i.e., they could have been increased.

Writing up an asset to reflect a purchase price for ratemaking purposes is normally disallowed, although it has been allowed under certain limited circumstances.[169] The

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[168] See 18 C.F.R. Part 353 Instruction No. 3-11 of the Instructions for Carrier Property Accounts(1998).

[169] See *Rio Grande Pipeline Company*, 78 FERC ¶ 61,020 (1997) and Longhorn Partners Pipeline, 82 FERC ¶ 61,146 (1998) and 82 FERC ¶ 61,147 (1998), in which the write-up the oil pipeline's rate base was denied. The *Longhorn* case, however, also contains a two prong test stating the limited circumstances under which the write-up of an acquisition rate base might be permitted. *See also Northern Border Pipeline Company v. FERC*, 129 F.3rd 1315 (D.C. Cir. 1997), citing 18 C.F.R. Pt. 201 at 526-27, holding that

increased equity component of the capital structure at issue here most likely results in a higher weighted cost of capital, and a higher return allowance (and rates) than would otherwise be the case. It also increases the deferred equity component of any improvements made after the formation of the partnership. This in turn accelerates the growth of the equity component of the capital structure and produces a higher equity component for the capital structure in subsequent rate cases.

The situation presented is a difficult one because the Commission's rate regulation of oil pipelines is generally more light-handed than that of gas pipelines. Nevertheless, under Longhorn and other Commission precedent, it is impermissible to revalue pipeline property and re-state equity balances for ratemaking purposes. Therefore SFPP is directed to exclude the effect of any revaluations of carrier property (including the elimination of accrued depreciation) that resulted from the formation of the SFPP partnership for ratemaking purposes, and to recalculate the cost-of-service used in this proceeding accordingly.

3. Projected Volumes.

The ALJ made several findings regarding the volumes to be used for rate design purposes on the West and East Lines. Only the findings related in whole or in part to the projection of East Line volumes are relevant here. The ALJ's determination to use calender year 1994 as the test year for the East Line volumes is generally not questioned here. However, several parties excepted to the ALJ's determination

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express permission is required and the company must justify the change under the so-called United criteria.

of how military volumes should be projected and one, Navajo, excepted to his conclusion that volumes projected to flow over the East Line after 1994 should not be included in the East Line projections.

With regard to military volumes, the ALJ held that since SFPP excluded costs of military facilities from its cost of service, that volumes should also be excluded from the South System cost of service. Numerous parties argued that this was incorrect. The Commission concludes that, as SFPP only excluded costs of the military laterals from its cost of service, the ALJ incorrectly excluded military volumes from the trunkline volumes to be used in designing the South System cost of service. Rather, only the revenues attributed to the section 22 rates should have been excluded from SFPP's cost of service and the volumes to the interconnect with the military facilities should have been included in SFPP's cost of service.

The ALJ also decided that possible volumes to be delivered to the El Paso area by a new Diamond Shamrock pipeline, arguably beginning in December 1995 and reaching full operations in 1996, should not be included in determining the projected throughput of the East Line. RHC reiterates that much of the throughput Diamond Shamrock will deliver to El Paso would necessarily flow over the East Line since the El Paso market cannot absorb all the product delivered. SFPP replies that El Paso is a growing market, that the product could move over Chevron's pipeline to another market, and that any additional volumes moving on the East Lines displace existing products. SFPP therefore supports the ALJ's determination that the potential impact of the Diamond Shamrock pipeline on SFPP's East Line is speculative at best.

The Commission affirms the ALJ. First, since the East Line is frequently constrained, it is difficult to determine on this record what the likely the impact of the Diamond Shamrock pipeline would be on the East Line other than displacement of existing volumes. The record does not contain the detailed volume forecasts for the period after December 31, 1994, that would permit this type of calculation. More importantly, the Diamond Shamrock pipeline was projected on this record to reach full operation only in late calender year 1996, a point that falls far outside the nine month known and measurable period for a 1994 test year. If the Diamond Shamrock pipeline is material to the total volumes transported on the East Line, this can be determined only in a subsequent rate case.

4. Cost of Capital.

The ALJ made several findings in determining SFPP's cost of capital. First, he determined the debt to equity ratio for SFPP's capital structure using the actual capital structure in 1994, 55.21 percent debt and 44.79 percent equity. This determination was challenged by Navajo to the extent that it did not reflect the removal of the accrued depreciation on SFPP's books as of December 18, 1988. This issue was decided earlier in the order. Thus, while the ALJ was correct in using the actual capital structure, its composition must be adjusted to exclude the effect of any revaluations of carrier property (including the elimination of accrued depreciation) that resulted from the formation of the SFPP partnership. The ALJ also used SFPP's actual 1994 cost of debt as the cost-of-debt component of the capital structure, which is unchallenged. The ALJ also used the actual inflation rate in 1994 for determining the inflation portion of the equity cost of capital, which was correct.

The disputes here turn on the proper method for determining the nominal cost of the equity component, with particular emphasis on the risk factor to be applied. In general, the ALJ adopted Staff's method, which involved developing a range of equity costs for six oil limited partnerships and a similar number of gas pipelines. Using a discounted cashflow methodology, the Staff selected the mid-point for the range of each mode, and then averaged the two. Asserting that SFPP has average risk, Staff concluded that the average mid-point of 12.87 percent was a reasonable nominal equity return for SFPP. Adopting this nominal return after discounting a number of risks raised by SFPP, the ALJ then deducted the actual 1994 inflation factor of 2.97 percent to get the allowed real return. All of these conclusions are challenged on exceptions.

The ALJ's adoption of the inflation factor is clearly correct under the Commission's test period methodology and is affirmed. However the other issues are more complicated. SFPP asserts that the ALJ improperly adopted the use of a combined average of gas and oil pipelines on the grounds that oil pipelines are more risky than gas pipelines, and conversely, that there is no evidence that they are equal in risk. SFPP also asserts that the ALJ improperly found that SFPP has low risks compared to other oil pipelines. SFPP further argues that the ALJ improperly rejected SFPP's proposed rate of return for SFPP, which was located at the lower end of range of equity returns for oil and gas pipelines. The Staff and the complainants support the ALJ, asserting among other things, that the use of the gas pipeline proxy was consistent with Commission precedent[170] and that SFPP faces

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[170] Staff Brief Opposing Exceptions at 24, citing *Kuparuk Transportation Company*, 55 FERC ¶ 61,122 at 61,380 (1991).

extraordinarily low risk. In addition the Commission has recently modified its methodology for determining the equity cost of capital,[171] an issue the ALJ recognized was in flux, [172] although this was not raised by the parties on exceptions.

As noted, Staff used an average of the mid-points of the estimated nominal equity cost of capital for six oil pipeline partnerships and seven gas pipelines. Staff selected this approach because there was no Commission guidance on how the nominal equity cost-of-capital should be decided for an oil pipeline partnership, although acknowledging that it was now possible to develop cost-of-capital determinations for such pipelines. The ALJ relied on this method, correctly stating that all parties used gas pipelines as a check on the reasonableness of the oil pipeline estimates.[173] On exceptions, SFPP asserts that the record discloses that the gas pipeline equity returns were consistently below those for oil pipelines. It concludes that averaging the gas and oil pipeline equity returns is improper since the two businesses have different returns, implying significantly different investor expectations.

Upon review, the Commission concludes that there is now sufficient evidence of market prices and trading patterns in oil partnership limited shares that only oil partnership equities should be used in developing the equity cost of capital for that industry. This is reflected in the exhibits which show two to three years of information for publicly traded oil pipeline

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[171] See Transcontinental Gas Pipe Line Corporation, (Opinion No. 414-A), 84 FERC ¶ 61,084 (1998).

[172] 80 FERC at 61,142, n. 226.

[173] *Id.* at 61,141.

partnership interests.[174] Thus, prior cases such as *ARCO*, *supra*, in which gas pipelines were a proxy for data that was not readily available, need no longer control. SFPP is correct that on this record, the DCF method indicates that in 1994, equity markets consistently imputed a higher equity cost of capital to oil than to gas pipelines. Under these circumstances, as SFPP asserts, averaging the two returns has the practical effect of stating that oil pipeline equities have unrealistically high returns compared to gas pipelines and lowering their allowable return below that would otherwise result from a DCF method.[175]

Given the growing ability to measure publicly traded oil pipeline partnerships, it was not necessary to average the estimated nominal equity cost of capital of oil and gas pipelines.[176]

All parties did encounter some difficulties in relying solely on a universe based on oil pipeline financial data. Specifically, there was disagreement on the use of the IBES or other data for determining the five year, short term growth component of the equity cost of capital. Staff correctly relied on the IBES as the standard Commission methodology and

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[174] Exh. 101, 3 of 4 and 4 of 4; Exh. 908 at 6-7.

[175] Even in *ARCO*, the Commission noted that the six gas pipelines used as the control group evidenced consistently less risk than was appropriate for *ARCO*. See 52 FERC at 61,243-44.

[176] Staff acted on the basis of a lack of Commission precedent and its testimony was thorough and candid in evaluating the strengths and weaknesses of relying only on an oil pipeline universe in evaluating SFPP's equity cost of capital.

SFPP's reliance on another forecasting source, Zacks, was incorrect.[177]

Moreover, all parties encountered some difficulty in dealing with the long-term component. SFPP argued initially that only the short-term component should be relied on, but also developed a long-term forecast based on the expected long-term growth in gas pipeline volumes. Staff initially relied on the anticipated long-term growth in the economy using the DRI forecast, but provided an alternative using the anticipated growth for long-term forecasts as well. The parties also disagreed about the relative weight of the short term and long term components, with Staff averaging the two and SFPP arguing that the shorter term component should have greater weight.[178]

These questions have been substantially answered by the Commission's recent decision in *Transco*, *supra*. In that decision the Commission affirmed use of the two-part method for determining a gas pipeline's equity cost of capital. It also affirmed the use of the IBES information for the five year short term period and the use of the anticipated growth in the domestic economy for the long term period. Thus, in both regards, Staff's initial proposal was the most appropriate method.[179] However, in *Transco*, the Commission also

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[177] 80 FERC at 65,142.

[178] *Id.*

[179] See *Transco*, 84 FERC at 61,423. To the extent additional long term forecasts are required under the *Transco* method, those in use in 1994 are a matter of public record and may be used in preparing a compliance filing. The sources should be included in the filing made a part of the record for comment by the other parties in their

determined that the short term component should be given greater weight than its long term component, in that case two/thirds, a position similar to that urged by SFPP. SFPP's cost of equity capital should be calculated in a manner consistent with *Transco*.

The final issue is the degree of SFPP's risk. First, as regards the ALJ's decision, the Commission concludes that the ALJ did not determine that SFPP faces low risks compared to other pipelines. In fact, he accepted Staff's determination that SFPP faces slightly higher financial risks and lower commercial risks and better growth prospects than most oil pipelines, and therefore should be considered to have average risk. A more appropriate reading of the ALJ's decision is that he rejected SFPP's arguments that SFPP faces high risks. In doing so, the ALJ rejected SFPP's arguments that it faces unique regulatory risks, environmental risks, risks due to possible earthquakes and floods, the impact of the Commission's *Lakehead* decision, and potential competition.

The ALJ's conclusions are supported by the record. For example, SFPP's risk under Lakehead and other aspects of regulation is theoretically the same as other oil pipeline's, and in fact one investment house thought that the Lakehead decision would not materially affect SFPP's long-term prospects.[180] The ALJ reasonably found that the earthquake and flood risks were not significant, and in any event, they are clearly less likely to happen in the portions of Arizona and New Mexico in which the East Line operations than in

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review of the compliance filing. *Transco*, 84 FERC at 61,246; *see also Iroquois*, 84 FERC at 61,453.

[180] See Exh. 826 at 5, 29.

California. As to the prospects of additional competition, SFPP's own 1988 Form S-1 Registration statement clearly states that the prospects of a competing oil refinery in Arizona and a new East Line competitor are unlikely,[181] which directly contradicts SFPP's assertions on brief. As the ALJ states, SFPP effectively conceded that the truck and rail modes are not effective transportation options.

The ALJ's implicit finding that SFPP does not face extraordinarily high risk is affirmed. Moreover, in this case the Commission is setting rates only for the East Line, which has consistently been faced with curtailment problems and has evidenced consistently high demand during the period at issue here. Given SFPP's transportation monopoly and evidence of continued growth, Staff correctly concluded that SFPP may face somewhat higher financial risk while also facing lower commercial risks.[182] SFPP's lower commercial risk is borne out by additional Staff testimony demonstrating that SFPP had the lowest variation in volumes of any publicly traded oil pipeline between 1998 and 1993,[183] and that its revenue has grown steadily except for a modest dip (less than one percent) in 1991.[184] Given Commission precedent at the time, Staff reasonably selected the mid-point of the equity range in developing SFPP's equity cost of capital. In any event, even with the difference in risk assumptions, the equity cost of

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[181] Exh. 863 at 48. This is an example of the contradictions that did little to enhance the credibility of SFPP's case.

[182] See. Exh. 281 at 8-13. For a similar result, see *Iroquois,* 84 FERC at 61,453-56.

[183] Exh. 288 at 1.

[184] *Id.* at 3.

capital estimates by Staff and SFPP's witness were remarkably close by the end of the hearing.[185] This consistency supports the result here.

However, in *Transco* the Commission modified this relatively mechanical approach of using the average of the range rather than the midpoint, and to then determine whether, based on the facts of the case, the equity cost of capital should be set at the average, the low end, or the high end of the range. In doing so, the Commission noted that if a pipeline faced relatively low risk, this could be the result of its own efficiencies and that to place its return at the lower end of the range would penalize the pipeline for its successes. Similar considerations apply here. While the current risks of operating the East Line, and therefore the risks to the attendant capital, appear relatively low, this does not detract from SFPP's efforts before 1994 to materially increase the capacity of its line. SFPP assumed the risk of the project in doing so and has met with success. Moreover, the Commission has no desire to discourage SFPP from pursuing similar risks in the future by lowering its equity return significantly below the average of its peers. Therefore, accepting Staff's conservative conclusion that SFPP faces average risks the Commission will adopt the average cost of capital for the oil pipeline sample used here.[186]

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[185] See Exh. 908 at 5, columns 1 and 6.

[186] The Commission earlier required SFPP to exclude the effect of any revaluations of carrier property (including the elimination of accrued depreciation) that resulted from the formation of the SFPP partnership. This may reduce the equity component in that year with adjustments in the later years to reflect the Opinion 154-B methodology. While this may indicate an increase in SFFP's financial risk, Staff's conclusion that it has average risk is

The calculations presently in record do not reflect the Commission's decision to weight the short term and long term components of the equity cost of capital by two thirds and one third respectively. However, the cost of equity capital that most accurately reflects the finding here is contained in Staff's Rebuttal testimony, Exhibits 281, 282 and 283. In this testimony, Staff witness Manganello developed a range of equity for oil pipelines. The upper end of the range was 14.85 percent and the lower end of the range was 12.74 percent with a median of 14.39 percent using the average of the long term and short term growth factors. SFFP is listed at 14.27 percent, or just below the median, a conclusion consistent with the Commission's prior finding that SFPP's risk is about that of an average pipeline. The Commission therefore concludes that SFPP's equity cost of capital should be calculated using Staff's rebuttal methodology adjusted for the new weighting that of the short and long term components required by Commission policy.

5. Income Taxes.

In this case the issue of income taxes centers on whether the *Lakehead* decision, Opinion Nos. 397 and 397-A, should be applied to SFPP, and if so, its scope. Opinion Nos. 397 and 397-A held that an oil pipeline limited partnership may not include in its cost of service a corporate income tax allowance for the partnership units that are held by individuals. The ALJ held that the *Lakehead* decision would apply to SFPP, but rejected arguments by several of the parties that SFPP should not be permitted to have any income

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conservative and this change need not affect the result here.

tax allowance.[187] Having held that *Lakehead* applied, the ALJ held that SFPP may not obtain an income tax allowance on income attributable to limited partners that are individuals, but may obtain an income tax allowance with respect to its corporate holders of limited partner interests. The ALJ also rejected SFPP's assertions that it should obtain an income tax allowance for unit holders that are not individuals, such as IRA's and trusts. The ALJ concluded that there was inadequate evidence whether these unit owners would actually pay taxes on the income received in the same manner as a corporation.[188]

SFPP excepts to the ALJ's determinations, arguing that application of the *Lakehead* doctrine would have a severe impact on the value of its partnership interests, that the policy should not be applied on the facts of this case, and that in any event, the policy should be applied only as of the effective date of the *Lakehead* decision, not retroactively to the date of the complaint. It also argues that the ALJ overlooked evidence on the income paying status of various unit holders, and that it is difficult to determine the status of such unit holders since many of the units are held in street name. Complainants assert that *Lakehead* should be applied and that it should be applied to all of the limited partnership interests, not simply those owned by corporate interests.

The Commission partially affirms the ALJ's determinations on the *Lakehead* issue. SFPP's position is no different from that of any other oil pipeline limited partnership, and there is no reason on this record to exempt

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[187] 80 FERC at 65,181.

[188] 80 FERC at 65,179.

it from *Lakehead*. To the extent *Lakehead* affects the value of SFPP's limited partnership interests, SFPP is in the same situation as all other oil pipeline limited partnerships. The ALJ reiterated the Commission's rationale for the *Lakehead* policy in detail and no further elaboration is required here.[189] The Commission also affirms his conclusion that SFPP should not obtain an income tax allowance for income attributed to interests other than Subchapter C corporations. While there are other forms of ownership, many are intended to avoid the double taxation that the owners of Subchapter C corporations incur, such as: street accounts, IRA's, Keogh, and other individual retirement plans (where the tax is deferred until distribution to the individual owner), trusts where the income is distributed to the beneficiary, and Subchapter S corporations. Absent better evidence of the tax paying attributes of these other ownership patterns, many of which are adopted to avoid double taxation, the ALJ was right to deny the allowance. As in *Lakehead*, a yearly listing of partners would be sufficient to determine whether a change in the mix of corporate and individual partners merits a change in rates under the cost-of-service method.

The ALJ also held that SFPP could not obtain an income tax allowance on the limited partner interests held by SFPP, Inc., a holding company that controls a 1 percent general partnership interest and 42.7 limited partnership interest in SFPP.[190] On September 6, 1990, SFP Pipeline Holdings,

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[189] 80 FERC at 65,177.

[190] SFPP, Inc. manages all of the Santa Fe Pacific Corp. holdings in the SFPP oil pipeline limited partnership. However, SFPP, Inc., is controlled 100 percent by SFP Pipeline Holdings, Inc., which is controlled by SFP Properties Inc., which is in turn owned by Santa Fe Pacific Corporation. See Exh. 870 for a diagram of full

Inc., which controls SFPP, Inc., issued some $218,981,000 in debentures with an interest obligation equal all of the dividend payouts made on the 42.7 percent of the limited partnership interests owned by SFPP, Inc. After noting that SFPP, Inc. is a corporate owner, and that as such an income tax allowance would normally be available for income attributed to the limited partnership interests SFPP. Inc. owns, the ALJ concluded that the sole purpose of the debentures was to assure that no Santa Fe Pacific unit would ever pay corporate income taxes on the income attributable to SFPP Inc.'s limited partnership interest.[191]

The ALJ therefore denied the income tax allowance on the grounds that such an allowance is available only for taxes actually paid. In doing so, he concluded that the Commission's stand-alone policy does not apply here. Under its stand-alone policy, the Commission provides a tax allowance on the actual corporate income tax liability associated with the pipeline's allowed return. This tax allowance is available to that entity even if offsetting deductions or losses at the consolidated level are used to offset the taxable income associated with the pipeline's allowed return. On exceptions, the Staff and the complainants support the ALJ, asserting that since no taxes will ever be paid on SFPP's partnership income, no income tax allowance should be permitted. Complainants therefore assert that SFPP has included phantom taxes in its cost of service. SFPP asserts that the stand-alone doctrine is valid here, that SFPP has paid taxes on its income on behalf of its parents, and that

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corporate structure.

[191] 80 FERC at 65,179.

there should be no penalty for the issuance of the debentures for general corporate purposes.

The Commission will reverse the ALJ and permit SFPP to have an income tax allowance on 42.7 percent of the limited partnership interests that are held by SFPP, Inc. The ALJ has misunderstood the Commission's stand-alone method by incorrectly considering the tax deductions of an affiliate in determining the stand-alone income tax allowance. The stand-alone method is one in which a utility is considered as nearly as possible on its own merits and not on those of its affiliates. It takes into account the revenues and costs entering into the regulated cost of service without increase or decrease for tax gains or losses related to other activities. The stand-alone method results in the tax allowance being equal to the tax the utility would pay on the basis of its projected revenues less deductions for all operating, maintenance, and interest expenses included in the cost of service. In short, it results in a tax allowance equal to the tax on the allowed return on equity.[192] Thus, only the income and deductions generated by SFPP are relevant. Because the interest expense generated by SFPP Inc.'s debentures is not included in SFPP's cost of service (because the company did not incur that expense in providing service), the deduction created by that expense is not considered in determining the stand-alone tax allowance. To do otherwise would result in subsidization of one entity by another. The tax allowance would then be lower or higher than is warranted by the profit (allowed return) provided by each. Under these circumstances, SFPP is correct that the stand-alone doctrine should apply and that it should obtain an income tax

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[192] See Columbia Gulf Transmission Company, 23 FERC ¶ 61,396 (1983).

allowance on the income attributed to the limited partnership interests owned by its corporate parent.

SFPP also asserts that if the Commission applies its *Lakehead* policy to this proceeding, that the policy should be applied on prospectively, not retroactively to the date of the complaint. The Commission has previously concluded that the *Lakehead* policy should be applied as of the date of the complaints in these proceedings.

Finally, the ALJ used the same capital structure to compute the interest, i.e, the debt, component of the allowed return and to determine the interest expense to be used in computing the tax allowance. SFPP opposed Navajo's exception to this ruling on the grounds that Opinion No. 351-A supports the ALJ's ruling.[193] As SFPP properly states, the same capital structure is to be used for "both the interest expense deduction and the allowed interest return,"[194] and, as discussed earlier in this order, under *ARCO* the capital structure is clearly to be adjusted to reflect the continued capitalization of the deferred equity component of any additional rate base investments.[195] The ALJ is affirmed.

6. Litigation Expenses

A major dispute among the parties in this proceeding is SFPP's proposed recovery of various types of litigation

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[193] Citing *ARCO Pipe Line Company*, 53 FERC ¶ 61,398 (1990) at 62,389.

[194] *Williams Pipe Line Company*, Opinion No. 154-C, 33 FERC 61,327 at 61,640 (1985).

[195] 53 FERC at 62,389.

expenses. These include costs related to this proceeding, costs incurred in litigation with the El Paso Refinery Company, and a settlement with Navajo and the related litigation costs in that proceeding. The ALJ concluded that SFPP would be allowed its actual Commission-related litigation costs incurred in 1994, or $2,631,815, to be amortized over five years. The ALJ rejected SFPP's attempts to establish a $15 million litigation expense base in 1994, to be amortized over 3 years. SFPP's $15 million figure included $3.1 million in actual litigation expenses and $12 million in a litigation reserve. The $3.1 million reflected the cost of all litigation in 1994, not simply Commission litigation in that year. The ALJ further ruled that if separate costs of service were to be allocated between the East and West Lines, one half of the expense should be allocated to each. The ALJ also held that any settlement payments to Navajo were non-recurring and that both the payments and the related litigation costs could not be included in the SFPP's cost of service. He also held that the litigation expenses should be recovered through a surcharge that would be removed from SFPP's rates once the expenses were recovered, and would not be part of its indexed costs.

Complainants and the Staff support the ALJ. Some assert that SFPP should not be permitted to recover any litigation expenses since it is entitled to those expenses only if it successfully defends the rates. They argue that the litigation reserve that SFPP established in 1994 does not reflect actual costs or those that would be known and measurable, and in any event SFPP has exercised no restraint and that its total legal fees are unreasonable.[196] They further state that

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[196] Navajo suggests that SFPP claimed its total legal expenses by the end of 1995 were $14.7 million, while further remarking that

allowing a reserve will serve to eliminate any restraint on a pipeline's legal expenditures expenses since the pipeline knows it can recover its legal fees from the ratepayers, and as such would simply be free to spend up to the amount of the reserve. At the same time, they assert, creating the reserve and amortizing it over a short period simply justifies a higher rate. They note that the instant complaints were filed in 1992, that all subsequent complaints have been held in abeyance, and that none of them are likely to go to trial before 1998, a period of at least 5 years. The complainants also support the exclusion of non-Commission litigation costs, including the cost of settlements between Navajo and SFPP, and a settlement of some $16 million between SFPP and El Paso. Navajo and RHC note that the non-Commission litigation benefited only Navajo and El Paso, and that much of the benefit involved attempts by East Line shippers to offset the disadvantage or damages that would result from increased capacity and benefits to West Line Shippers when SFPP decided to reverse the flow of the 6 inch line between Phoenix and Tucson. They conclude that none of the litigation or settlement costs should be included in SFPP's cost of service, and recommend that any litigation expenses actually allowed be allocated between the East and the West Lines on the basis of throughput, not the 50-50 allocation suggested by Staff.

On exceptions SFPP asserts that it is entitled to the full recovery of all its litigation expenses and the settlement costs of its disputes with Navajo and El Paso. It asserts that the

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SFPP's total annual cost of service for the East Lines was $14 million. It further asserts that these costs were inflated by spending to advance positions that are contrary to well-established policy and to hire experts to file extensive testimony on marginal issues. Navajo Brief Opposing Exceptions at 66.

recovery of expenses for rate litigation is never limited simply to those cases where the pipeline wins, nor should the recovery of such expenses be based on judgements about whether the pipeline's litigating theories were correct. It further argues that most parties have not seriously challenged the level of expenditures, and states that for its part, the high level of legal fees comes from continuous challenges to its rates by its shippers, and the novelty of the issues involved. Moreover, it asserts that much of the litigation was engendered by disputes between shippers on the East and West lines over the addition of capacity to the SFPP system, the impact of such changes on their respective commercial positions, and their relative rate levels.

Specifically, SFPP asserts that the litigation about the collapse of El Paso, the ARCO Reversal Agreement, and the timeliness of the expansion relate directly to disputes about the allocation and pricing of pipeline capacity and market access by its shippers. SFPP also argues that settlement of the civil litigation reduced the potential cost, and exposure, of an expensive jury trial. It also asserts that the level of allowed legal expenses for 1994, to be amortized over 5 years, does not reflect anywhere near the costs that were actually incurred in 1993, 1994, and 1995, which exceeded the $15.1 million reserve created in 1994. It concludes that to limit the recovery of litigation expenses to those actually incurred in 1994 deprives it of any reasonable opportunity to recover its costs. SFPP has no objection to using a surcharge, and asserts that if litigation costs are to be allocated among the East and West Lines, the 50 percent allocation suggested by Staff is the only one supported by the record.

The Commission will affirm the ALJ in part and reverse the ALJ in part. The Commission agrees that settlement costs involving El Paso and Navajo are non-recurring costs that

arose out of litigation unique to the conditions of those two parties. However, the litigation expenses related to these settlements are part of SFPP's normal, and ongoing, disputes with its shippers regarding the costs and capacity allocations of its South Lines. Therefore the Commission will allow SFPP its full 1994 test period litigation costs.[197] The Commission will affirm the ALJ's determination that the costs should be amortized over 5 years, the period for which the 1994 rates have remained in effect. The first year in which the charge will be amortized is 1994, meaning that the amortization will be completed in 1998, coterminous with the conclusion on the bulk of the litigation connected with the complaints.

The Commission also agrees with RHC that litigation expenses should be divided among the East and West Lines on the basis of relative volumes, and not the 50-50 basis suggested by Staff. Many of the issues involved in this proceeding, including substantially changed circumstances, allocation of costs in California, and the ARCO Reversal Agreement have been raised primarily by West Line shippers. To the extent there are common issues, allocation of one half of the expenses to the East Line shippers does not reflect their relative use of the South Line system or, as has been previously discussed, SFPP's relative investment, or revenues, in the different portions of the South Lines. Those litigation costs are to be allocated accordingly.

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[197] *Williston Basin Interstate Pipeline Co.*, 84 FERC ¶ 61,081 at 61,365-66. In this case the Commission adopted the traditional three-year average for regulatory costs. However, consistent with the instant case, the Commission rejected Staff's efforts to reduce the average based on anticipated lower costs in later years.

The Commission will deny SFPP's efforts to create a reserve in calender year 1994 based on its anticipated litigation expenses. While subsequent years established that SFPP's estimate of the costs to be incurred was accurate, the protesting parties are right that those costs could not have been known and measurable in 1994 since they were only anticipated. If anything, the use of the reserve creates the incentive for a self-fulfilling prophecy to the extent the reserve becomes the basis for including costs in a rate base. However, in its compliance filing SFPP may seek to recover additional litigation costs in excess of the 5-year amortization amount if those are incurred in the years between 1994 and 1998. Moreover, the Commission will not necessarily preclude the recovery of litigation costs incurred in the years after 1994 in determining whether reparations should be awarded in this proceeding.

7. Power Costs

The ALJ ruled that any rate design of SFPP's East Line rates should be based on 1994 actual volumes.[198] As a secondary point, the ALJ held that, to the extent that 1993 volumes are adjusted upward, an "exponential factor" of 2.0 should be used to develop the related fuel costs. RHC excepted to this finding. As SFPP points out in reply, this only becomes an issue if 1994 throughput volumes are not used to design the East Line rates. Since the Commission has affirmed the ALJ in this regard and directed that actual 1994 costs be used in the related compliance filing, there is no need to consider this exception further.

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[198] 80 FERC at 65,185.

8. Reconditioning costs

The ALJ reviewed, and rejected, a large reserve that SFPP created in 1994 for the purpose of funding the reconditioning of a substantial portion of the South System over 15 years. The reserve would have increased SFPP's operating expenses by at least $3 million in 1994. The ALJ rejected the expense on the grounds that almost no such expense was incurred in 1994, and that in fact of some $320,000 initially claimed, only $20,000 was properly expensed and the rest should have been capitalized.[199] He also concluded that the projected $3 million did not meet the nine-month known and measurable criteria used in Commission rate making proceedings and must be rejected for that reason. He considered SFPP's engineering assumptions about the rate of deterioration, the need for repair, and the expense likely to be incurred as too speculative to warrant inclusion of the projected costs in SFPP's rates. As an example, he noted that of the total reconditioning costs projected in 1995, one-half were eventually capitalized as replacement costs, not repairs.[200]

On exceptions the complainants and the Staff support the ALJ. They assert that SFPP had not committed to a firm reconditioning program by the end of 1995, that the Board of Directors had been told that the projected program would be less than the $3.5 million claimed in this litigation,[201] that SFPP had not followed standard industry practice in developing the estimate, and that SFPP's own principal

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[199] 80 FERC at 65,168.

[200] 80 FERC at 65,169.

[201] Citing Exh. 816.

witness had conceded that the program could vary significantly from year to year. They further assert that only 25 percent of SFPP's actual expenditures in 1995 to stabilize the integrity of the pipe had actually been expensed, and that the rest was capitalized, that between 1993 and 1995 SFPP capitalized 95 percent of its line reconditioning costs, that there were no contractual provisions to support the proposed expenditures,[202] and that SFPP stubbornly clung to its estimated expenses for 1993 and 1994 long after discovery established that they had in fact been capitalized. Staff submits that the Commission accepts adjustments to the projected test-period costs if there are significant actual changes during the nine-month adjustment period which are pertinent to the issue, and which justify making the adjustment.[203]

In reply, SFPP asserts that its consultants and engineers developed an appropriate reconditioning program, that it was properly approved by Board of Directors in 1994, and that the expense projection is appropriate. It asserts that it has monitored the pipe at issue for 40 years, that federal safety programs require the reconditioning of the pipe, and that its witnesses establish that the pipeline's coating is bad and has disbonded in locations too numerous to consider making spot repairs. It addresses the scheduling issues by stating that its witnesses acknowledged that the area in which the work was actually performed might vary from the original projections, but that this did not detract from its intention to recoat 30 miles of pipe a year on its South Lines.

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[202] Distinguishing *Kuparuk Transportation Company*, 45 FERC ¶ 63,006 at 65,079-080 (1988).

[203] Citing *Williston Basin Interstate Pipeline Company*, 56 FERC ¶ 61,104 at 61,371 (1991).

SFPP further argues that reconditioning is a labor-intensive program requiring the unearthing, testing, and coating of some 500 miles of 8-inch and 6-inch pipe, the maximum possible for a labor intensive program. It asserts that the record establishes that this work is being performed on a regular basis and to preclude any recovery is too harsh. In this regard, it says that, work performed in 1996 totaled 30 miles and involved recoating and that 14 miles of the pipe replaced in 1995 was to repair damage caused by a contractor. In the alternative, SFPP suggests that ALJ should have permitted it to have formula rate that would allow SFPP to adjust its cost of service to reflect expenditures that were actually made, and notes that the West Line shippers proposed a surcharge for this purpose and to recover environmental costs as well.

The record here strongly supports the ALJ's conclusion that SFPP should not be permitted to include a reconditioning expense in its cost of service. No such costs were incurred in 1993 or 1994, and the amount in 1995 was minimal, even assuming that the accounting basis for the actual expenditures was changed. The engineering basis for the reconditioning program was strongly contested, although the need for the program is supported to the extent that SFPP actually replaced a substantial amount of pipe (and capitalized the cost) rather than reconditioning, and expensing, the costs. As the complainants assert, since the replacements are capitalized and not expensed, allowing the $3 million expense in 1995 would have overstated both the total outlay and allowed recovery of the program costs both as repair expense and a depreciation expense in subsequent years.

The test period concept, with the nine month known and measurable adjustment period, is a relatively rigid concept simply because there must be some point at which the record

closes and there is a known, factual basis for the conclusions. Given Commission practice in this regard, SFPP has failed to establish the validity of the proposed expenditures. However, to the extent that SFPP actually incurred reconditioning expenses after 1995, it may use those expenses as a basis for supplementing its compliance filing by simultaneously filing new rates to reflect those costs. In light of this ruling, it is not necessary to address SFPP's argument that it should be permitted to utilize a formula rate to recover its reconditioning expenses. The action here is not intended to prejudge the possible use of such a mechanism. Moreover, the Commission will consider any reconditioning costs that SFPP may have actually incurred between calender year 1994 and December 31, 1998, in determining whether reparations are due.

9. Environmental Costs

As with its reconditioning expenses, SFPP included in its 1994 cost of service a large expense item to cover the costs of an environmental reserve it created to cover anticipated remedial obligations and awards. SFPP first created the reserve in late 1992 after the instant cases were filed and proposed to amortize the reserve over five years. The ALJ denied most of this expense on grounds similar to his denial of SFPP's proposed reconditioning expenses. Noting the environmental reserve was based primarily on SFPP's management's estimates, he did permit the inclusion in the 1994 cost of service of $553,942 that SFPP actually incurred in that year. The complainants support the ALJ's conclusion that the reserves are speculative and are not adequately supported by the record. SFPP asserts that the environmental reserves are justified by the liability exposure that became known to it between 1992 and 1994. It further states that it created and reported the reserves consistent with the

requirements of generally accepted accounting principles and SEC reporting.[204] The amortization in the test year under SFPP's theory would be $764,500.[205]

The Commission will affirm the ALJ. SFPP's reserve for environmental costs is based on estimated expenses, and initially included large amounts that were more appropriately allocated to southern California operations and to non-jurisdictional operations (particularly terminals) in Arizona. At hearing the estimates were adjusted to reflect a more precise allocation to the South Line system for the 1994 test year.[3] However, as the ALJ states, while SFPP's environmental reserves may reflect its management's best estimate of costs it may incur because of complex environmental litigation, there is no basis for determining whether the costs actually paid will be within the five-year amortization period, or longer.[4] As with reconditioning expenses, SFPP has failed to establish the validity of the proposed expenditures. SFPP may have created the reserve in compliance with generally accepted accounting principles and SEC disclosure requirements, but somewhat different rate regulation considerations are involved.

Specifically, if the environmental remediation estimates are not actually expended but are collected from shippers, it is unlikely that SFPP's future rates (which may be based on an index rather than SFPP's cost of service) would reflect refunds of unexpended amounts. If that were to occur, undeserved profits would accrue to SFPP's investors. However, as with SFPP's proposed costs for pipeline

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[204] See SFPP's Brief on Exceptions at 95, footnote 89.

[205] *Id.*, 97.

reconditioning, the East Line rates at issue here are to be adjusted prospectively, and SFPP may file to recover any increase in its environmental costs that may be justified by actual experience from January 1, 1995, to the date of its filing to comply with this order. Moreover, as with the litigation costs, SFPP may utilize its actual environmental costs for the years 1995 through 1998 in calculating the amount of reparations that may be due under this order. In contrast, if SFPP creates a reserve by taking a deduction against income and part of the reserve is not eventually spent as contemplated, the reserve can be liquidated, the amounts previously deducted declared as income, and any surplus cash becomes available for general corporate purposes. Thus, unlike the case of the ratepayer, the shareholder may recoup any funds that are not actually expended for the purpose for which the reserve was created. However, as with SFPP's proposed costs for pipeline reconditioning, the East Line rates at issue here are to be adjusted prospectively, and SFPP may file to recover any increase in its environmental costs that may be justified by actual experience from January 1, 1995, to the date of its filing to comply with this order. Moreover, as with the litigation costs, SFPP may utilize its actual environmental costs for the years 1995 through 1998 in calculating the amount of reparations hat may be due under this order.

10. Post-Retirement Benefits other than Pensions.

SFPP included in its proposed cost of service an allowance for post-retirement benefits other than pensions (PBOP). Under SFPP's accrual method, the allowance includes future benefits for employees who were actually employed during the year used for the cost of service in this proceeding. As the ALJ stated, accrual accounting for PBOP

expenses is mandatory under SFAS 106.[206] However, as the ALJ also stated, because the accrual basis for recognizing expenses for rate purposes can provide regulated companies with collections of ratepayer funds years in advance of the period when the funds will be expended, the Commission established policies to ensure the payment of benefits to employees and to provide that post-retirement benefits are accounted for properly in establishing rates.[207] Among these was the requirement that all regulated companies wishing to obtain an allowance for the accrual of PBOP expenses must establish an external trust fund to hold the funds generated by that PBOP allowance contained in its rates. It is undisputed that SFPP did not establish an external fund.

The Commission's PBOP Policy Statement applies to oil pipelines on a case-by-case basis.[208] In this case, the ALJ denied the accrued PBOP expense that SFPP had included in its cost of service. He did so in part based on SFPP's history

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[206] The Financial Accounting Standards Board ("FASB") issued SFAS 106 in December 1990. SFAS 106 requires that, for fiscal years beginning after December 15, 1992, employers reflect in current expense an accrual for post-retirement benefits other than pensions during the working lives of covered employees. SFAS 106 essentially finds that PBOP plans are "deferred compensation arrangements whereby an employer promises to exchange future benefits for employees' current service and that their cost should be recognized over the employees' service periods for financial accounting and reporting services." *Post-Employment Benefits Other Than Pensions*, Docket No. PL93-1-000, Statement on Policy ("Policy Statement"), 61 FERC ¶ 61,330, at p. 62,199 (1992), *reh'g denied*, 65 FERC ¶ 61,035 (1993).

[207] Policy Statement, 61 FERC ¶ 61,330, at p. 62,200.

[208] 61 FERC at 62,202-03.

of managing its PBOP accruals. The ALJ noted that under the accrual method, SFPP booked an annual expense for PBOPs in an amount of $2.231 million in 1992, $1.555 million in 1993 and $1.5 million in 1994.[209] Having thereby increased its cost of service by those amounts in each of those years, SFPP then amended its plan in 1994, reducing the plan benefits. The result was that SFPP recorded a gain in the amount of $3.1 million on its 1994 financial statements.[210] Moreover, by that plan amendment, SFPP also was able to reduce plan expenses to only $770,000 in 1995.[211] He concluded that, although SFPP increased its cost of service in 1992, 1993 and 1994 by plan expenses on an accrual basis, it made no correcting or crediting entry to the benefit of the ratepayers when it modified the plan in 1994 and thereby captured a $3.1 million gain, and that requirement of the external fund was intended to prevent this type of behavior.[212] The ALJ therefore limited SFPP to its 1994 actual cash expenditures for pension and other retirement benefits.

On exceptions, the Staff and most complainants support the ALJ. SFPP excepts, arguing first that the Commission can make exceptions to requirement of an external trust fund on a case by case basis, and that in any event it restructured its former plan in the 1994 test year. It argues that restructuring the plan in 1994 established a new amount for the annual PBOP accrual, and that this is the amount properly included in the 1994 cost of service to be collected

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[209] See Ex. 719.

[210] Ex. 337 at pp. 12-13.

[211] Ex. 719.

[212] 80 FERC at 65,172-73.

prospectively through its rates. SFPP states that under these circumstances there is no reason to deny SFPP an allowance based on its 1994 accruals.

The Commission will affirm the ALJ because he correctly applied the Commission's PBOP Policy Statement to the circumstances of this case. In the instant case, SFPP chose not to comply with the PBOP Policy Statement's requirement to establish an irrevocable trust for the benefit of its employees, and within two years of implementation of SFAS 106, amended the plan and reduced benefits, recognizing a gain for its investors. SFPP's actions conflicted with the express purpose of the Commission's PBOP Policy Statement:

> FASB statements permit in certain instances gains realized on settlements and curtailments of post-retirement plans to be taken to income. Recognition of income by the regulated company without a concurrent reduction in rates would not be fair to ratepayers, particularly if any shortfalls in fund assets are to be made up through increased future rates. That would be the effect of adopting the accounting principles of SFAS 106 for ratemaking purposes. A mandatory requirement to establish an irrevocable trust will prevent the company from realizing income not intended to be earned when the rates were originally established by the Commission.[213]

Given this, SFPP should not be allowed to reflect the accrued amount of its PBOP costs in its cost of service. SFPP will only be allowed to include amounts that were actually

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[213] Policy Statement, 61 FERC ¶ 61,330, at p. 62,202.

paid in 1994 with respect to retired plan participants for benefits earned in prior periods, i.e., amounts determined using the pay-as-you-go method.[214] However, if between December 31, 1993 and the date of its compliance filing, SFPP has created an irrevocable external trust in which to place any net PBOP expense accruals (including any gains realized on plan amendments, settlements and curtailments) it may adjust its proposed compliance filing to retain a PBOP accrual component. Moreover, if SFPP has created this external trust, it may credit any PBOP expenses accrued between December 31, 1993 and December 31, 1998 in excess of pay-as-you-go amounts, to any reparations that might otherwise be required by this order.

D. Reparations.

The initial decision contains an extensive discussion of whether and when reparations may be available in the instant proceeding.[215] The ALJ first held that since the West Line Shippers had not shown substantially changed circumstances, they were not entitled to reparations for shipments on the West Line. The Commission has affirmed the ALJ's conclusion on substantially changed circumstances and affirms this conclusion as well. He also held that Navajo's prior settlement with SFPP barred Navajo from recovering reparations for the two year period prior to the date of its complaint. While Navajo asserts otherwise, the ALJ pointed out that the only reasonable interpretation of Navajo's 1989 settlement with SFPP is that Navajo is barred from seeking reparations for the time frame that its settlement was in effect.

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[214] 80 FERC ¶ 65,173.

[215] 80 FERC at 65,201-208

The Commission agrees, and on this point the ALJ's ruling is affirmed for the reasons stated in his ruling.[216]

The ALJ also held that the East Line Shippers were entitled to reparations for the two year period before the date of their complaints, except, as noted, for Navajo. The ALJ also held that the West Line shippers were not entitled to obtain reparations for shipments they made on the East Line if those rates should be determined to be unjust and unreasonable. The ALJ also ruled that shippers who had not requested reparations in their initial complaints could obtain reparations from the date of their original complaint upon filing an amended complaint.[217] The ALJ then used a test-period concept in determining the level of reparations. He concluded that once a just and reasonable rate is established to be applied prospectively, the same rate should be used to determine the level of reparations in the previous years.[218]

SFPP excepts to the conclusion that reparations may be obtained two years before the complaint if the existing rate is not grandfathered, arguing that equitable considerations are such that reparations should not be awarded for any of the rates at issue here if they should be found unjust and unreasonable. SFPP also argues that reparations cannot be obtained through an amended complaint that relates back to the date of the original complaint. Both SFPP and Chevron object to the determination that reparations should be awarded on a test year basis. They argue that the reparations for any

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[216] 80 FERC at 65,207-08.

[217] 80 FERC at 65,205-06.

[218] 80 FERC at 65,202-203.

year other than the test year should be determined based on the actual costs and revenues incurred in that year.

SFPP further argues that if reparations cover a period of several years, reparations should be made only if total revenues exceeded the total cost of service in the years to which the reparations would apply. SFPP claims that otherwise it would be required to absorb the losses from underrecoveries while surrendering the surpluses for the years for which there was an overrecovery. The West Line Shippers object to any determination that they may not obtain reparations for shipments that they may have made over SFPP's East Lines. The complainants also assert that reparations should be available from the date of an initial complaint, not from the date of an amended complaint first raising the reparations issue. They argue that this is consistent with federal court practice and the Commission's regulations.

There is no dispute that reparations are available to some degree for shipments over the East Lines if those rates are determined to be unjust and unreasonable. The debate turns rather on which parties may be eligible for reparations and the period for which they are to awarded. Reparations have traditionally been considered an equitable remedy, and whether they are granted is a matter of Commission's discretion.[219]

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[219] Refunds under the Natural Gas Act are also at the Commission's discretion. Reparations are not available under the NGA since rate changes in complaint cases are only effective prospectively under section 5 of the NGA.

Upon consideration of the relevant precedent, the Commission is affirming the ALJ's determination that reparations are available on a "relation-back" basis. The complainants assert that requiring a request for reparations to be included in the initial complaint is an anachronistic practice, while SFPP asserts that the weight of Interstate Commerce Commission (ICC) and related court authority supports this conclusion. The Commission concludes that the ICC and Surface Transportation Board have become more liberal in recent years, for example, permitting a request for reparations to relate back to the date of an informal complaint.[220] While SFPP cites to federal cases to the contrary,[221] these cases dealt with contract matters in federal court and not rate cases before a regulatory agency vested with authority under the ICA. However, as the ALJ stated, the Commission normally follows the Federal Rules of Procedure in deciding procedural issues.[222] Given the relaxation of strict forms of pleading since the Federal Rules of Procedure were adopted, the Commission will permit reparations to be awarded back to the date of the original complaint.

The Commission also concludes that in this proceeding reparations should not be awarded for any period before the filing date of the East Line complaints. All of these complaints were filed while SFPP's 1988 settlement rates were in effect, rates that had been agreed to by the majority

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[220] See 80 FERC ¶ 65,204-05, citing *Thompson Phosphate Co. v. Atlanta Coast Line*, 282 F. Supp. 698 (S.D.N.Y. 1968).

[221] See 80 FERC at ¶ 65,204, n. 851.

[222] 80 FERC at 65,205, citing Revere Petroleum Corp., 60 FERC ¶ 63,023 at 65,192 (1992).

of the shippers using the system at the time the settlements were made. While the Commission only approved, and did not adjudicate, the settlement rates, SFPP undertook a substantial expansion of its system in reliance on those settlement rates. Until such time as the rates were called into question by the filing of the complaints, there was no reason for SFPP, or the Commission, to have grounds to believe that the settlement rates entered into with most of its shippers were not just and reasonable, or that the shippers themselves may have thought otherwise. Therefore, the Commission will not award reparations for the period proceeding any of the complaints involved in these proceedings.

For the period after the complaints were filed to the date of this decision, SFPP was on notice that its rates were the source of some considerable dissatisfaction, that they would be subject to review, and that there was a risk that the rates could be found unjust and unreasonable and reparations awarded. SFPP had the choice of litigating the rates, or attempting to reach a settlement with its shippers to resolve their disagreements. The Commission agrees with the complainants that holding that no reparations would be due in this proceeding removes much of the incentive for the pipeline to settle or to act with restraint in the litigation. The Commission also agrees with SFPP that to award reparations automatically lessens the restraint that shippers may feel in filing complaints against that pipeline, which several shippers have done repetitively. The number of unique issues involved in this proceeding and the fact that it has been protracted may also influence how reparations should be determined. However, since the Commission does not have before it the means to estimate reparations at this time, it will take no further action then to say in general terms for what time frames reparations may be available and how the reparations that may be due in this proceeding are to be calculated.

Thus, the period for reparations will commence from the date of each complaint until March 31, 1999, the effective date of any revised East Line rates required by this order. To calculate the potential reparations, SFPP shall develop an East Line cost of service for the test year 1994, design a rate that reflects that cost of service and conforms to this order, and index the rate so designed to December 31, 1998. Utilizing the indexed rates thus developed, SFPP will apply those rates to the design volumes adopted by this order for each calender year for which an indexed rate has been developed, thus establishing a new cost of service for each of the subsequent years. Thereafter, for each of the five years 1994 to 1998, and the partial year 1999 through February 28, 1999, SFPP shall determine whether the revenues for each subsequent period resulted in over- or underecovery of its cost of service for each of those years. For any reparations that may be due for the years prior to 1994, SFPP shall develop a separate cost of service applying the rulings stated in this order and shall determine whether it over- or underrecovered its cost of service in those years. As stated earlier, no reparations will be due for periods prior to the filing date of a complaint.

SFPP may also develop, as supplementary cost items for each such year, additional costs or cost factors that the Commission concluded were not to be included in the 1994 test year cost of service, but which were actually incurred in the years 1995 through 1998. Such costs may include litigation, settlement, reconditioning, and environmental expenses as actually incurred, not as estimated or accrued. Any such costs must be reflected as a separate line item for the year involved and be supported by SFPP's regulatory reports and work papers. SFPP may also include a PBOP allowance for time periods for which there was an external trust fund conforming to the Commission's policies. SFPP shall show a separate revised net income figure for each of

the five years 1994-1998 to reflect any such additional costs. Any of the additional cost claims shall be fully supported by work papers and accounting records that should be available to all parties and the Commission.

The Commission concludes that the final amount of reparations due should be calculated on a total cost of service basis for the period for which the reparations are due. Since the proper cost of service has been at issue for several years and SFPP was entitled to defend its existing rates, the Commission does not believe that it is equitable to require SFPP to make reparations for the years in which it may have overrecovered its cost of service, and to absorb the losses in which it underrecovered its cost of service. Prospectively, as a matter of normal rate design practice, SFPP is at risk for the underrecoveries and may keep any overrecoveries pending action in another rate case; moreover, if the underrecoveries are protracted, SFPP may file for a rate increase. This symmetry is maintained if SFPP is permitted to net out the fat and lean years that may occur during the time frame for which reparations may be due. Therefore, SFPP's final calculation will be to net out its over- and underrecoveries for each year and determine that net amount, if any, that is due its East Line shippers.

E. The Publication of Prorationing Policies

One of the issues consolidated with this proceeding was a proposal made by SFPP on July 31, 1992, to change its prorationing policies. The proposed change was not filed with the Commission but was distributed by letter to SFPP's shippers. Under the new policy, new shipper volumes, or increased volumes by an existing shipper, would be awarded only to those shippers who could show demonstrated need. The proposed change was protested by El Paso in the context

of SFPP's filing Tariff Nos. 15, 16, and 17, which was made to cancel certain existing SFPP tariffs. El Paso asserted that the modified prorationing policy should have been included in SFPP's tariff, and that the "demonstrated need" policy was so vague as to be unjustly and unduly discriminatory and inimical to El Paso's interests. Chevron filed a similar protest on September 23, 1992, also stating that the proposed policy left too much discretion in the hands of the pipeline. On September 29, 1992, the Oil Pipeline Board suspended the proposed tariff changes and set the issue for hearing.[223]

The ALJ concluded that SFPP was required to publish the details of its prorationing policy in its FERC tariff. He based this conclusion on the language of the ICAct and section 341.8 of the Commission's regulations.[224] He further concluded that SFPP had not justified the use of the so-called demonstrated need test and that test afforded SFPP too much discretion and opportunities for discrimination. He therefore ruled that SFPP should adopt a good faith nomination test as an alternative policy, stating that the good faith test reflected general industry practice. He also ruled that, when investigating the practicality of shipper nominations, SFPP should refrain from contacting any parties with whom SFPP's shippers have business dealings, and that SFPP should respond to requests regarding capacity within 30 days after it receives an inquiry.[225] On exceptions, all the intervening shippers and the Staff supported the ALJ's determination for the reasons stated in his order.

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[223] SFPP., L.P., 60 FERC ¶ 62,252 (1992).

[224] 18 C.F.R. ¶ 341.8 (1998).

[225] 80 FERC at 65,196-201.

SFPP excepts to the ALJ's determinations on several grounds. It asserts that the ALJ's ruling is inconsistent with the Commission's decision in *Total Petroleum, Inc. v. Citgo Prods. Pipeline*,[226] and a recent Court of Appeals ruling in *ARCO Alaska, Inc. v. FERC*,[227] both of which SFPP claims limited the inclusion of detailed prorationing provisions in an oil pipeline's tariff. SFPP further asserts that the issue here is improperly framed as whether there should be a modification to SFPP's current prorationing policy, and that no party has proved that the demonstrated need policy has resulted in any preferential treatment among shippers. SFPP states that its prorationing policy allocates capacity among shippers in times of constraint in proportion to their prior twelve-month average, and that the "demonstrated need" standard is intended to assure that new shippers do not displace existing shippers without adequately justifying their need for the capacity. It further claims that the "good faith" standard provides incentives for over- nominations and double counting, as demonstrated by its own experience.[228] Finally, it argues that on this record there is no basis for concluding that SFPP's allowable response time should be reduced from 90 to 30 days.

The Commission finds that SFPP is not required to include the details of its current prorationing policy in its tariff. Upon review, the complaining parties are correct that SFPP incorrectly cited *ARCO*, *supra*, for the proposition that the Commission has no authority to require oil pipelines to include prorationing rules in their tariffs. ARCO only held

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[226] 76 FERC ¶ 61,164 (1996).

[227] 89 F.2d 878 (D.C. Cir. 1996).

[228] Citing Exh. 147 at 24-28.

that the Commission could not require pipelines to include in their tariffs contracts or guidelines for allocating capacity among themselves since the requirement to publish tariffs attached to the pipeline's relationship with the shipper. However, SFPP is correct that the Commission's prior decision in *Total*, *supra*, is on point here. Under *Total* the Commission has construed Section 341.8 of its regulations as only requiring a summary of the proration policy and information on where to obtain the more detailed policy statement. The ALJ is reversed in this regard.

In *Total*, the pipeline provided its shippers with 45-days notice of the proposed changes and noted that the policy would be changed in a tariff filing. In the instant case, the hearing record discloses that SFPP mailed its revised policy on July 31, 1992, to be effective October 1, 1992.[229] To the extent that shippers thought that they had received less than 30 days notice before their next nomination deadline, they were mistaken.[230] SFPP's action in providing notice was consistent with *Total*, but, as *Total* requires, SFPP should have filed a tariff identifying its modified prorationing policies.

Based on the forgoing, the Commission concludes that SFPP's existing tariff on prorationing does not comply with the Commission's standards. While the tariff states that in case of prorationing, capacity will be allocated on a nondiscriminatory basis, the tariff does not clearly state that a more detailed prorationing circular exists, and where it can be obtained. Nor does SFPP's tariff state the minimum notice

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[229] Tr. 5471.

[230] *Id.*; *see also* Exhs. 903 and 904.

period for any proposed changes to the detailed policy circular. SFPP must modify its tariffs accordingly. The Commission also has some concerns regarding the more detailed circular itself. First, the outside reply date for SFPP to respond to a request for capacity is 90 days. The Commission concludes that this lengthy time frame is inconsistent with SFPP's obligation to provide transportation service upon reasonable request. Given the competitive nature of the petroleum industry and the need to determine whether capacity will be available to support an executory contract, the Commission concludes that responses should be made within 30 days. The Commission is also concerned that SFPP's contacting of a shipper's customers could discourage the customer from contracting for a sale, either inadvertently or due to some unanticipated favoritism at the operating level. Given that SFPP has not in the past found it necessary to contact a shipper's customers, the Commission concludes that it should delete the right to do so from its detailed policy statement.

Beyond the matters just discussed, the Commission concludes that the complaining parties have not established that SFPP's "demonstrated need" policy is unjust and unreasonable, the burden they have in a complaint case,[231] or

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[231] The instant case is a complaint case because SFPP did not change the tariff provisions related to its prorationing policy when it filed Tariff No. 17. Rather, the Oil Pipeline Board used the filing of that tariff, which contained SFPP's existing tariff language, to set the issue of whether the tariff, and the underlying detailed circular, were just and reasonable for hearing. 60 FERC at 63,508. While suspension of the entire tariff was customary under section 15(7), for those provisions of the tariff that were not a modification from SFPP's previous tariffs, the protesting parties have the burden of proof under section 13(1) of the IC Act.

that the so-called "good faith" test is necessarily the only just and reasonable provision that should be used. The complaining parties assert that the "demonstrated need" standard provides the pipeline undue discretion and an undue opportunity to discriminate. Yet they fail to show actual harm by SFPP's use of the standard to allocate capacity. Moreover, Staff's citation to an ARCO tariff[232] as a model of the "good faith' standard is unconvincing. The ARCO tariff expressly provides that a new shipper must provide a realistic 12 month forecast of the volumes to be shipped and nominate in good faith. In the event of a capacity shortage, ARCO reserves the right to "accept and transport, during such period, only that portion of each good-faith offer to ship which Carrier shall determine to be equitable among all Shippers."[233] Under this standard, ARCO has as much discretion to deny capacity as SFPP does under its tariff as the standards for the review are not stated, and may do so after the nominations are made. In SFPP's case, the determination should be normally made before nominations are submitted and shippers will know were they stand at that time.

SFPP's procedures are also very similar to that used by another petroleum pipeline, Colonial.[234] It is noteworthy that SFPP changed its prorationing policy because a number of smaller shippers believed that they were being unjustly denied access to capacity and that much of the opposition came from large existing shippers who feared that they would lose their

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[232] Exh. 117.

[233] *Id.*

[234] See Exh. 151.

existing capacity.[235] Thus, if Staff's concern is that SFPP's revised policy would discriminate against small shippers, the record indicates that this was the very concern that the policy change was intended to address. Existing shippers are concerned that if a new shipper over-nominated during times of constraint and then failed to ship, the existing shipper would lose an opportunity for a sale which would not be compensated for by penalties imposed by the pipeline.[236] In this regard, SFPP also established that it is possible for a new shipper to over nominate when the system is constrained and still not appear to have done so.[237] Therefore no further action will be taken on this issue.

IV. Remaining Procedural Issues and Conclusions.

The Commission has determined that the West Line Shippers, Mobil, TOSCO, and ARCO have not proven substantially changed circumstances as of the dates of their complaints against SFPP's West Line rates in these consolidated proceedings. Therefore those complaints are dismissed and the proceedings are closed. Since the last of

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[235] See Exhs. 98-104.

[236] See Tr. at 5463-4, 5465, 5472.

[237] See Tr. At 8009-11. For example, if the system is constrained, the curtailment factor is 50 percent, and the new shipper intends to only ship 10,000 barrels while nominating 20,000, the abuse would not be detected because the amount available under prorationing would just be 10,000 barrels. However, the amount of capacity available to other shippers is reduced by 5000 barrels since this is the amount the new shipper would be limited to if SFPP were able to verify that the amount that was likely to be shipped was only 10,000 barrels rather than the 20,000 nominated.

the consolidated complaints was filed on August 7, 1995, the issues of substantially changed circumstances on SFPP's West Line and the reasonableness of the West Line rates are closed through the date of the last complaint. Thus, with the exception of a further complaint by Navajo, any complaint filed against SFPP's West Line rates filed after August 7, 1995 must establish substantially changed circumstances as of the date of that complaint in a manner that is consistent with this order. The Commission will elaborate in a separate order the procedures to be followed in evaluating the series of complaints filed against SFPP's rates subsequent to August 7, 1995.

The Commission has also found that some of the theories with which SFPP has sought to defend its East Line rates were not justified on this record. Thus, to the extent that the current level of SFPP's East Line rates depends on those theories or arguments, they may not be just and reasonable, and to that extent modifications to the related cost elements are required. This in turn may reduce SFPP's cost of service for 1994 below the rates that were in effect during that year. SFPP is therefore directed to recalculate its East Line rates for the year 1994 in a manner consistent with this order. In its compliance filing SFPP must state the recalculated rate, how the rate was devised, and must provide supporting memorandum work papers, and estimate reparations, if any, in the manner discussed earlier in the order. Both the compliance filing and any comments must be supported by specific citations to this order and to the portions of the record upon which any party relies in its filing.

Finally, if SFPP believes that any revisions to its East Line rates that may result from this order are too low to recover its costs as of the effective date of the revised rates, it may make a filing to raise the rates to a higher level at the

time it makes its compliance filing to this order. SFPP will have the burden of establishing that any such new or refiled rate is just and reasonable under the ICAct and that its proposal is consistent with the findings of this order.

THE COMMISSION ORDERS:

(A) The complaints against SFPP's West Line in this consolidated proceeding are dismissed. The dismissal of those complaints is without prejudice to complaints that may have been filed against SFPP's West Line rates after August 7, 1995.

(B) SFPP's East Line rates may not be just and reasonable for the year ended December 31, 1994 for the reasons stated in this order. Within 30 days after this order issues SFPP shall file revised tariffs reflecting the changes to the calculation of its East Line rates required by this order for the years 1994, 1995, 1996, 1997, and 1998, as indexed to a current level pursuant to the Commission's indexing regulations published at 18 C.F.R. § 342.3, with any prospective East Line rates to be effective March 1, 1999. SFPP shall estimate any reparations that may be due as required in the body of this order.

(C) If, based on the compliance filing required by Paragraph B, SFPP's East Line rates are determined to be just and reasonable, the complaints against the East Line rates will be dismissed for all complaints filed before August 7, 1995. If the East Line rates are determined not to be just and reasonable pursuant to paragraph B, the Commission will determine at a later date whether reparations should be made based on the compliance filing required by paragraph B.

(D) SFPP's base rates for the indexing of its West Line rates shall be those in effect on October 24, 1992, and for the indexing of its East Line rates, those established as of the effective date of this order if the compliance filing discloses that the rates on the East Line must be modified. Otherwise, the base rates for the indexing of its East Line rates shall be those in effect as of October 24, 1992.

(E) SFPP must file a tariff reflecting the current charges for its Watson Station drain dry facilities within 30 days after this order issues.

By the Commission.

(SEAL)

Linwood A. Watson, Jr.,
Acting Secretary.

Appendix A – System Map – omitted

APPENDIX E

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

SFPP, L.P.

Docket Nos. IS92-39-001, IS92-21-001, and OR92-8-000

[Issued April 2, 1993]

Before Commissioners: Elizabeth Anne Moler, Chair; Charles A. Trabandt, Jerry J. Langdon, Martin L. Allday, and Branko Terzic.

ORDER ON EXCEPTIONS

These are exceptions to orders issued by the Oil Pipeline Board, suspending and establishing an investigation, pursuant to section 15(7) of the Interstate Commerce Act (ICA),[1] of certain tariffs filed by SFPP, L.P. For reasons explained below, the Commission will vacate the suspensions and imposition of refund obligations, and provide for adjudication of the contested issues in further appropriate proceedings.

Background of Pertinent Facts

SFPP operates a pipeline system that transports refined petroleum products into Tucson and Phoenix, Arizona, from

[1] 49 App. U. S. C. § 15(7) (1988).

points east and west of these cities. The western routes originate in the Los Angeles, California area, and the eastern routes originate in El Paso, Texas. On July 31, 1992, SFPP filed three revised tariffs (FERC Tariff Nos. 15, 16 & 17) to take effect on September 1, 1992. Subsequently, the pipeline filed a supplement to the revised tariffs to postpone the effective date until October 1, 1992. The revised tariffs proposed to change SFPP's existing tariffs by adding a new origination point at East Hynes, in North Long Beach, Los Angeles County, and charging a rate for service from this point.

El Paso Refinery, L.P., and Chevron U.S.A. Products Company are shippers on SFPP's eastern routes, sending their products west from El Paso to Tucson and Phoenix. They filed protests against the revised tariffs.[2] El Paso further requested that its protest be considered in the alternative as a complaint if the Commission found that a protest was not the proper vehicle for raising its claims. El Paso challenged two aspects of SFPP's operations -- the reversal of product movement on a six-inch line between Tucson and Phoenix so that products would be transported on this line from Phoenix to Tucson rather than in the other direction,[3] and revisions to the pipeline's prorationing policies and practices. According to the El Paso protest, these actions by SFPP are unduly discriminatory, anticompetitive, and taken without fair and

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[2] El Paso filed on September 4, and Chevron filed on September 23, 1992. The Chevron protest was filed late, bu the Board granted the company's request to waive the filing deadline.

[3] However, prior to August 1, 1991, product was transported on this line east from Phoenix to Tucson. The flow was reversed, to move product west from Tucson to Phoenix, for the period August, 1991 to August, 1992.

sufficiently descriptive notice to shippers. Thus, SFPP is alleged to have violated several provisions of the ICA, including sections 1(4), 1(6), 3(1), 6(1) and 6(3). Finally, El Paso also claimed that SFPP's new practices rendered its existing rates to shippers on the eastern routes unjust and unreasonable. Chevron's protest similarly challenged the legality and fairness of the flow reversal and prorationing policies. Neither El Paso nor Chevron specifically protested the addition of the East Hynes origination point or the rate for service from that point, and neither protestant presented any material indicating it had an economic interest in these changes.

On September 29, 1992, the Board issued an order accepting and suspending SFPP's revised tariffs subject to investigation and refund, and established hearing procedures.[4] The Board in that order stated:

> El Paso's and Chevron's protests raise serious statutory concerns as to the lawfulness of SFPP, L.P.'s proposed filing. El Paso alleges that SFPP, L.P. has engaged in unduly discriminatory and unreasonably preferential practices affecting the transportation service provided by SFPP, L.P. El Paso asserts the absence of a tariff provision explaining the line reversal itself, and SFPP, L.P.'s related proration practices are in violation of Sections 1(6), 6(1), and 6(3) of the ICA. Chevron also asserts that the lack of a published proration policy may be

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[4] 60 FERC § 62,252 (1992).

potentially discriminatory among existing shippers. Such allegations warrant further investigation.[5]

For these reasons the Board suspended the effective date of the revised tariffs for one day,[6] ordered the pipeline to keep a record of amounts received under the revised tariffs sufficient to allow refunds to be made if the rates were found to be unlawful, and instituted an investigation. The Board stated that it was taking these actions pursuant to the authority granted in section 15(7) of the ICA and applicable Commission regulations.

On October 5, 1992 the Commission issued a Notice of Complaint in Docket No. OR92-8-000 in response to El Paso's protest/complaint filing, and ordered answers to such complaint to be filed by November 4, 1992. SFPP answered by arguing that El Paso's protest should not be allowed to be treated in the alternative as a complaint.

On October 19, 1992, SFPP filed exceptions to the Board's order pursuant to Rule 1902(b) of the Commission's Rules of Practice and Procedure[7] from the Board's order. The pipeline argues that the Board exceeded its authority in suspending the revised tariffs and imposing accounting and refund obligations with respect to operations -- flow reversal and prorationing -- which were existing practices and did not involve, and were not proposed as, changes to its existing

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[5] *Id.* at p. 63,508.

[6] The Board stated it was suspending one of the tariffs (FERC No. 17) because it contained the same prorationing language challenged by the protestants in the other two revised tariffs.

[7] 18 CFR § 1902(b) (1992).

tariffs. SFPP's position is that only the addition of the East Hynes origination point is subject to suspension and other remedial procedures under section 15(7) because it is the only tariff provision proposed to be changed in its filing. The pipeline therefore specifically excepts to the Board's ordering of the suspension, and of accounting and potential refund obligations with respect to other provisions of the revised tariffs.

In answering SFPP's appeal, El Paso and Chevron maintain that the pipeline has instituted new practices and should not be allowed to shield itself from a section 15(7) investigation merely because its has failed -- unlawfully -- to provide notice of these changes in its tariffs. Protestants dispute SFPP's characterization of its revised tariffs as mere restatements (except for the addition of the East Hynes origination point) of existing policies and practices.

Finally, on December 31, 1992, SFPP filed FERC Tariff No. 18 for the purpose of transporting a new product (turbine fuel) on its western route from points in California to Tucson. No other changes to its practices were proposed. El Paso and Chevron lodged protests, arguing that SFPP's latest tariff filing raised the same issues raised by the earlier proposed tariffs. These parties also challenged the new rate proposed to be charged in FERC Tariff No. 18, contending it warranted investigation because of changed throughput levels on SFPP's system and because it was the same rate set for investigation by the Board's order of September 29, 1992.

The Board issued an order, on January 29, 1993, suspending and instituting a section 15(7) investigation on

SFPP's FERC Tariff No. 18.[8] The Board stated that based upon a review of SFPP's filing, and protestants' allegations, it found that the proposed tariff had not been shown to be just and reasonable and warranted investigation. Further, because the filing raised issues similar to those that were raised in Docket No. IS92-39- 000, the Board ordered proceedings in this new matter, Docket No. IS93-21-000, to be consolidated with proceedings in Docket No. IS92-39-000.

SFPP has filed exceptions to the Board's January 29, 1993 order, arguing that it should be reversed for the same reasons the order of September 29, 1992, should be reversed.[9] Chevron filed a reply, arguing that the existence of a written agreement between SFPP and a shipper, pursuant to which the pipeline made its decision to reverse the flow of product between Phoenix and Tucson, supports the claims of undue discrimination and anticompetitive conduct.

Discussion

SFPP filed revised tariffs on July 31, 1992, to add an origination point on its western route and provide a rate for service from that point, and on December 31, 1992, to transport a new product on its western route from points in California to Tucson. The pipeline proposed no other changes to its practices in either filing.

El Paso and Chevron did not directly challenge these proposed changes, but instead disputed certain existing practices -- flow reversal, prorationing, and existing rate

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[8] 62 FERC § 62,060 (1993).

[9] The appeal was filed February 19, 1993.

levels[10] -- that SFPP did not propose to change. The Board concluded that the issues raised by El Paso and Chevron warranted suspension of both tariff filings, imposition of potential refund obligations, and an investigation pursuant to section 15(7).

The Board erred. Although the Commission, and therefore its delegatee, the Board, has broad authority under section 15(7) to suspend tariff filings and impose potential refund obligations, invocation of these procedures in this case was not warranted.

SFPP's proposed tariff changes were narrow in scope and, importantly, not directly challenged. Rather, El Paso and Chevron disputed certain existing practices that the pipeline did not propose to change. Under these circumstances, the most appropriate vehicle for conducting an investigation is section 13(1), not section 15(7). The challenges to SFPP's tariff filings fall into two categories of issues: first, whether SFPP has improperly failed to describe certain existing practices and failed to give notice of changes in such practices and, second, whether the practices themselves are unduly discriminatory, anticompetitive or otherwise unlawful. Both categories of issues present the question of whether SFPP has, with respect to its past and existing, as opposed to its proposed, practices, fulfilled the requirements imposed upon

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[10] Although El Paso's protest of the December 31, 1992 filing purported to challenge the proposed rate, it is clear that the claim it raised is the same it made with respect to the earlier filing -- that the existing rates on SFPP's system needed examination in light of new throughput levels. Further, the rate proposed in the December 31, 1992 tariff is not one which El Paso has an economic interest, since it does not ship, or propose to ship, product on the western route.

it by the ICA. Section 13(1) is available for examining precisely this question. This provision reads in relevant part as follows: "Any person . . . complaining of anything done or omitted to be done by any common carrier subject to the provisions of this chapter in contravention of the provisions thereof, may apply to said Commission by petition . . . ."

El Paso in effect submitted such a petition when it challenged SFPP's July 31, 1992 filing, and the Commission concludes that its allegations as to the unlawfulness of SFPP's past and existing practices with respect to flow reversal,[11] prorationing, and current rates, are the kind intended by the statute for adjudication under section 13(1). It was not appropriate for the Board to suspend the proposed tariff changes and initiate an investigation under section 15(7) when the focus of the protest was existing, unchanged, portions of the tariff.

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[11] The parties argue whether flow reversal may be subject to a suspension order, with SFPP claiming that it is a nonjurisdictional matter. It is true that the ICA does not confer upon the Commission jurisdiction over abandonment of existing services. *See Arco Pipe Line Company*, 55 FERC ¶ 61,420 (1991). In this case, however, it is not clear whether the flow reversal is an abandonment, or merely a reduction in existing service to eastern routes shippers. This is because there is another line operated by SFPP that continues to move product from Tucson to Phoenix, so that despite the flow reversal on the six-inch line, shippers in the El Paso area are still able to send refined products (albeit a lesser amount) via pipeline to Phoenix. The jurisidictional issue raised by these facts may be addressed on the merits in the course of the proceedings following this order, where all evidence necessary to render an appropriate decision will be adduced.

The Board does not possess delegated authority to order initiation of a section 13(1) proceeding, but the Commission has already taken the first step in doing so through its October 5, 1992 Notice of Complaint. Moreover, the proceedings in Docket No. IS92-39-000 generally have been consistent with a proceeding under section 13(1).[12] The presiding judge has issued a ruling properly placing upon El Paso and Chevron the burden of going forward with the evidence with respect to whether SFPP has exercised market power in a discriminatory manner in its flow reversal and prorationing policies. In addition, SFPP has moved for bifurcation of proceedings in order to obtain light-handed, market-based regulatory treatment of its rates pursuant to *Buckeye Pipe Line Co.*, 45 FERC ¶ 61,046 (1988), and therefore is now pursuing in

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[12] On February 4, 1993, El Paso filed a request for "Immediate Action" on SFPP's appeal. El Paso states that Atlantic Richfield Company (ARCO) has filed a suit in an Arizona court seeking a declaratory judgment as to its rights under a contract with SFPP to transport product on the pipeline, and that the complaint in this suit supports El Paso's claim that SFPP is discriminating against east line shippers. El Paso reiterates its position that the Commission should deny SFPP's appeal, and also requests a declaratory judgment as to this agency's exclusive jurisdiction of the issues raised in ARCO's state court action.

The Commission notes that there are now three state court actions, in three different states (Arizona, New Mexico, and Texas), in which various shippers are pressing their interpretation of contracts they made, or allegedly made, with SFPP. In each such case, the issue of the court's jurisdiction, in light of this agency's jurisdiction under the ICA, may be raised and resolved with appropriate remedies. At this point, therefore, the Commission discerns no useful purpose in expressing an opinion as to the respective scope of authority of this agency and state courts in regard to alleged contracts to ship petroleum products.

these proceedings a much broader objective than evidenced in its July 31, 1992 filings. Thus, the Commission will provide for investigation of the issues raised by El Paso and Chevron in accordance with section 13(1).

Given the current posture, and much changed nature, of these dockets, the Commission concludes that it would be appropriate and equitable to minimize disruption to the ongoing proceedings. Therefore, the Commission will only vacate those parts of the Board's orders of September 29, 1992[13] and January 29, 1993 that suspended SFPP's revised tariff filings and imposed refund obligations. The Commission will consolidate the complaint docket with the ongoing proceedings in Docket Nos. IS92-39-000[14] and IS93-21-000. The burden of proof on the issues of flow reversal, prorationing and reasonableness of existing rates shall, as previously ruled by the presiding judge, be upon those parties challenging those practices.

If SFPP, following upon this order, desires to terminate its Buckeye case and have proceedings go forward solely under the complaint docket, it may file an appropriate motion with the presiding judge.

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[13] SFPP also excepted to a statement contained in the Board's September 29, 1992 order characterizing the nature of the pipeline system. The statement, however, was clearly not intended as a finding of fact.

[14] The Commission recently issued an order lifting the suspension of proceedings in Docket No. IS92-39-000 that had been ordered by the Chief Judge. Staff testimony will be due on August 31, 1993. 62 FERC ¶ 61,168 (1993).

THE COMMISSION ORDERS:

(A) The suspensions and refund obligation imposed by the order issued on September 29, 1992, and January 29, 1993 of the Oil Pipeline Board, are vacated.

(B) The request of SFPP, L.P., to dismiss Docket No. OR92-8-000 is denied.

(C) Docket No. OR92-8-000 is consolidated with proceedings in Docket Nos. IS92-39-000 and IS93-21-000.

By the Commission.

(SEAL)

Lois D. Cashell,
Secretary.

APPENDIX F

Docket No. IS92-39-000

[Issued September 29, 1992]

UNITED STATES OF AMERICA 60 FERC ¶ 62,252
FEDERAL ENERGY REGULATORY COMMISSION

OIL PIPELINE RATES: SUSPENSION

Before Oil Pipeline Board Members: Jerie P. O'Connor, Chairman; Richard V. Mattingly, Jr., William P. Bushey Kenneth M. Anderson, and Marvin Rosenberg.

ORDER ACCEPTING FOR FILING AND SUSPENDING TARIFFS AND TARIFF SUPPLEMENTS, SUBJECT TO INVESTIGATION AND REFUND, AND ESTABLISHING HEARING PROCEDURES

On July 31, 1992, SFPP, L.P. filed FERC Tariff Nos. 15, 16, and 17 (canceling FERC Tariff Nos. 12, 13, and 14, respectively) with a proposed effective date of September 1, 1992. On August 28, 1992, SFPP, L.P. filed Postponement Supplements No. 1 to FERC Tariff Nos. 15, 16, and 17 under authority of Special Permission Docket No. SP92-15-000[1] to

[1] As justification for the special permission request SFPP, L.P. stated the physical connections would not be completed at the new origin point by September 1, 1992. Accordingly, SFPP, L.P.

postpone the effective date of the tariffs from September 1, 1992, to October 1, 1992. FERC Tariff Nos. 15, 16, and 17 were filed to add a new origin point and applicable rates at East Hynes, North Long Beach, Los Angeles County, California. The new rates are the same as the rates currently in effect from Watson and Norwalk, California. There are no other changes contained in the tariffs.

Protests

On September 4, 1992, El Paso Refinery, L.P. (El Paso) filed a protest and motion to intervene (or, in the alternative, a complaint) protesting FERC Tariff Nos. 15 and 16 and requesting emergency relief from the Commission to require SFPP, L.P. to cease and desist the reversal of flow of the East Line System. On September 9, 1992, El Paso filed a supplement to the requesting the Commission suspend the filing for the maximum statutory period of seven-months and requesting an early hearing on the issues raised in its protest. On September 24, 1992, El Paso filed to cite the correct authority, 18 C.F.R. § 385.1403 to protest a proposed oil pipeline filing.

El Paso's principal business is owning and operating petroleum refinery in El Paso, Texas. El Paso states it is a supplier and shipper on SFPP, L.P.'s East Line system. SFPP, L.P. operates two separate refined petroleum products pipeline systems serving Tucson and Phoenix, Arizona. The first system originates in El Paso, Texas and extends

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requested the effective date of the tariffs be postponed to ensure that the effective date of the tariffs instituting service from the new origin point would not precede the date on which SFPP, L.P. was physically able provide the service.

westward to serve Tucson and Phoenix and is referred to as the "East Line." The second system originates in the Los Angeles, California area and extends eastward to serve Phoenix and is referred to as the "West Line." SFPP, L.P. is the only petroleum products pipeline serving these Arizona markets.

El Paso states in order to make deliveries of California product to Tucson, on or about August 1, 1992, SFPP, L.P. actually commenced the reversal of flow of one of the two East Line pipelines (the "Six-Inch Line"), a line which, during the past year has been used to deliver East Line refiners' products from Tucson to Phoenix under FERC Tariff No. 13. El Paso maintains the effect of this line reversal will be to reduce the volume of petroleum products which the already prorated East Line shippers are capable of delivering into the Phoenix market by 12,000 BPD, at a substantial cost to Phoenix consumers.

El Paso believes that SFPP, L.P. is now attempting discriminate against East Line shippers by restricting the volume of petroleum product that can be delivered into the Phoenix market to the benefit of West Line shippers and the pipeline's shareholders.

El Paso contends that by letter dated July 31, 1992, SFPP, L.P. notified El Paso that it was modifying its Proration Policy to take into account "market circumstances that were not encountered during previous proration periods." The new proration policy was scheduled to become effective with September's shipments. Under this new policy, new shipper volumes will be awarded to only those shippers who can show demonstrated need. SFPP, L.P. also informed El Paso penalties may be imposed for non-complying shippers. El Paso asserts that SFPP, L.P.'s tariff has not been modified in

any respect and fails to articulate a specific capacity allocation plan or proration formula. The tariff provides only that when more petroleum product is tendered than can be currently transported the carrier will determine the method to be equitable to all shippers. However, the tariff does not state what that method is. El Paso requests that the language of Item 35 be stricken because it provides the carrier undue discretion and fails to define the terms "equitable," "demonstrated need," or list any penalties which it plans to impose on shippers. By failing to include specifics, El Paso states the pipeline retains the opportunity to arbitrarily change policy, with little or no notice to shippers and preclude the Commission from any meaningful oversight.

El Paso states the rule may be applied in a discriminatory manner in violation of Section 3(1) of the ICA. El Paso further alleges that the proration method which has been implemented by SFPP, L.P. in the past and which is not included in the pipeline's tariff, has been arbitrarily and inconsistently applied.

El Paso asserts that by failing to articulate an proration methodology in its tariffs, and by failing to draft a tariff provision authorizing the imposition of penalties non-complying shippers, SFPP, L.P. will be in violation of several provisions of the ICA including Sections 1(6), 6(1), and 6(3) of the ICA. El Paso asserts that SFPP, L.P. has failed to establish a "transportation practice" regarding proration of capacity and regarding the imposition of penalties. In addition, this failure is in contravention of the notice provisions of Section 6(1) of the ICA. El Paso complains that by failing to publish, file, and keep open to public inspection tariffs which plainly state the practices and terms and conditions of service, the carrier is not affording adequate notice as required by statute. EL Paso further

complains SFPP, L.P. has violated Section 6(3) of the ICA which provides that changes must be noticed. El Paso states shippers on SFPP, L.P. have been denied effective notice and an opportunity to comment on and object to SFPP, L.P.'s proration activities because of the pipeline's failure to satisfy its statutory duties.

On September 23, 1992, Chevron U.S.A. Products Company, (Chevron) filed a protest and motion to intervene[2] requesting that SFPP, L.P.'s FERC Tariff Nos. 15 and 16 be suspended for one day. Chevron states that even before the reversal of the Six Inch Line, the East Line was in prorationing. Chevron states by letter dated July 31, 1992, SFPP, L.P. notified Chevron that it was modifying its proration policy; however, the new policy was not included as part of the new tariff filings. Chevron asserts that SFPP, L.P. has now informed Chevron that it will institute the new prorationing policy for October shipments. Chevron maintains the new policy will have a substantial and potentially adverse impact on Chevron's ability to transport product on SFPP, L.P.'s pipeline. The reason for this, Chevron states, is because the new policy treats existing shippers' requests for increased space as a request from a new shipper. Chevron asserts it would therefore accord additional space to some existing suppliers by reducing the capacity available to other existing shippers.

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[2] On September 24, 1992, Chevron filed an amendment to its protest requesting a waiver of 18 C.F.R. § 385.1403 which requires that protests and interventions must be filed 12 days before the effective date of the tariffs. The Board believes good cause has been shown to grant waiver of the rule in this instance.

It is Chevron's view that the new policy appears to offer the potential for discriminatory treatment of existing shippers. Chevron states that SFPP, L.P. should be required to include its prorationing policy in its tariff so that both the Commission and interested parties can review it for conformance with the requirements of the ICA.

DISCUSSION

El Paso's and Chevron's protests raise serious statutory concerns as to the lawfulness of SFPP, L.P.'s proposed filing. El Paso alleges that SFPP, L.P. has engaged in unduly discriminatory and unreasonably preferential practices affecting the transportation service provided by SFPP, L.P. El Paso asserts the absence of a tariff provision explaining the line reversal itself, and SFPP, L.P.'s related proration practices are in violation of Sections 1(6), 3(1), 6(1), and 6(3) of the ICA. Chevron also asserts that the lack of a published proration policy may be potentially discriminatory among existing shippers. Such allegations warrant further investigation.

Based upon a review of SFPP, L.P.'s filing and El Paso's and Chevron's protests, the Board finds the proposed tariffs and supplements have not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory, or otherwise unlawful. In addition, the Board notes that while El Paso and Chevron only protested SFPP, L.P.'s FERC Tariff Nos. 15 and 16 for a lack of a specific proration policy, the proration rule of FERC Tariff No. 17 contains the same language as the protested tariffs. Therefore, the Board believes it is appropriate to also suspend and investigate FERC Tariff No. 17. Accordingly, the Board shall accept SFPP, L.P.'s proposed tariffs and

supplements for filing, suspend their effectiveness, subject to investigation and refund and the conditions set forth below.

Generally, the Board has suspended oil pipeline tariff filings for one day absent the protestant showing severe "anticompetitive effects" or "undue hardship" as enunciated by the Commission in the Buckeye decision.[3] El Paso has not demonstrated that the pipeline's actions justify a longer suspension period herein. Further, Chevron has requested only a one-day suspension. In light of these circumstances the Board believes a one day suspension period is justified in this instance.

Pursuant to the policy set forth by the Commission in Buckeye Pipeline Company, order issued December 24, 1980, in Docket Nos. IS80-76 and IS80-47, et al., (13 FERC ¶ 61,267) the length of the suspension period shall be one day. Accordingly, the Board shall suspend FERC Tariff Nos. 15, 16, and 17 and Postponement Supplements No. 1 related thereto for a period of one day until October 2, 1992, when those tariffs and supplements shall be permitted to become effective subject to investigation and refund.

Pursuant to 49 U.S.C. § 15(7), and 18 C.F.R. § 340.1, the Board shall require SFPP, L.P. to keep accurate account of all rates collected subject to refund. The interest on any refunds shall be determined as set forth in Ordering Paragraph (B) below. A Presiding Administrative Law Judge shall be designated to convene a prehearing conference in this case.

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[3] 13 FERC ¶ 61,267 at p. 61,596 (1980).

THE BOARD ORDERS:

(A) Pursuant to 49 U.S.C. § 15(7) an investigation shall be instituted into the lawfulness of SFPP, L.P.'s FERC Tariff Nos. 15, 16, and 17 and Postponement Supplements No. 1 related thereto. Pending hearing and decision, SFPP, L.P.'s proposed FERC Tariff Nos. 15, 16, and 17 and Postponement Supplements No. 1 to FERC Tariff Nos. 15, 16, and 17 are accepted for filing and suspended for one day until October 2, 1992, when the tariffs and supplements shall be permitted to become effective subject to refund.

(B) Pursuant to 18 C.F.R. § 340.1, SFPP, L.P. shall keep accurate account of all amounts received by reason of the instant filing, specifying when, by whom, and in whose behalf such amounts are paid. The accounts shall be in sufficient detail so that refunds with interest can be ordered of any portion of the rates ultimately found unjustified.

(C) A Presiding Administrative Law Judge, to be designated by the Chief Administrative Law Judge for that purpose (18 C.F.R. § 375.305) shall convene a prehearing conference in this proceeding to be held in a hearing or conference room of Federal Energy Regulatory Commission, 810 First Street, N.E., Washington, D.C., 20426. The prehearing conference shall be held for the purpose of establishing any procedural dates necessary for the hearing. The Presiding Administrative Law Judge is authorized to conduct further proceedings in accordance with this order and the Rules of Practice and Procedure.

(D) If no answers in opposition to El Paso's and Chevron's Motions to Intervene are filed within 15 days after the issuance of this order, they will become parties to this proceeding at the end of the period pursuant to 18 C.F.R. § 385.1403.

By the Oil Pipeline Board.

Jerie P. O'Connor
Chairman
Oil Pipeline Board

APPENDIX G

FERC No.15
(Cancels FERC No.12)

Filed
Office of the Secretary
92 JUL 31 PM 2:30
Federal Energy
Regulatory Commission

SUSPENDED
IN I. & S. Docket BY
IS92-39-000

SFPP, L.P.
LOCAL PIPELINE TARIFF 8-Y
(Cancels SFPP, L.P. Tariff 8-X)

Applying On
PETROLEUM PRODUCTS
As Defined Herein

FROM STATIONS AT
Watson, Cal.
(N) East Hynes , Cal.
Norwalk, Cal.

TO STATIONS AT	Rate in Cents Per Barrel
Phoenix ,Ariz.	126.2

FROM STATIONS AT
El Paso, Tex.

TO STATIONS AT	Rate in Cents Per Barrel
Lordsburg, N.M.	48.0
Tucson, Ariz.	73.1
Phoenix, Ariz.	101.2

FROM STATIONS AT
Richmond, Cal.
Concord, Cal.

TO STATIONS AT	Rate in Cents Per Barrel
Reno (Sparks), Nev.	110.0

FROM STATIONS AT
Portland (Willbridge-Linnton), Ore.

TO STATIONS AT	Rate in Cents Per Barrel
Salem, Ore.	① 24.9
Albany, Ore.	28.9
Eugene, Ore.	45.6

SUBJECT TO RULES AND REGULATIONS SHOWN IN ITEMS 10 to 130 INCLUSIVE.

NOTICE

For explanation of reference marks see concluding page of this Tariff.

This carrier certifies it is fully offering and when requested, impartially providing its obligated services and fully observing all requirements of law and regulations prescribed by the Commission.

NOTICE — The provisions published herein will, if effective, not result in an effect on the quality of the human environment

ISSUED: JULY 31, 1992
EFFECTIVE: SEPTEMBER 1, 1992

Issued by
Irvin Toole, Jr., President
Santa Fe Pacific Pipelines, Inc.
General Partner of SFPP, L.P.
888 South Figueroa Street Los Angeles, California 90017

ITEM 10
SUBJECT Definitions
RULES AND REGULATIONS

Term "Barrel" as used herein refers to forty-two (42) gallons, United States measurement, at 60 degrees (60) Fahrenheit.

Term "Carrier" as used hereto refers to SFPP, L.P.

Term "Products" as used herein refers to petroleum products described in Item 20.

ITEM 2O
SUBJECT Articles on Which Rates Apply
RULES AND REGULATIONS

Rates published in this tariff apply on the following petroleum products:

Gasolines

Petroleum Distillate Fuel Oils.

ITEM30
SUBJECT Minimum Tender and Delivery Requirements
RULES AND REGULATIONS

The minimum quantity of any one product of quality and specifications described herein which wall be accepted at one point of origin from one shipper shall be 5000 barrels, except at Watson and Norwalk, California, where the minimum quantity shall be 10,000 barrels, and at Portland, Oregon where the minimum quantity shall be 2,500 barrels.

The minimum quantity which will be delivered at any destination station or intermediate storage shall be 2,500 barrels, except at Colton, California, where the minimum quantity delivered shall be 5,000 barrels.

ITEM 35
SUBJECT Proration of Pipeline Capacity
RULES AND REGULATIONS

When more petroleum product is offered by shippers to the carrier under this tariff than can be currently transported within the period covered by such offers, petroleum products offered by each shipper for transportation will be transported in such quantities and at such times to the limit of carrier's capacity in a manner determined by carrier to be equitable to all shippers.

ITEM 4O
SUBJECT Acceptance of Products
RULES AND REGULATIONS

Products will be accepted for transportation:

(a) At such time as products of compatible quality and specifications are currently being transported from receiving point to destination. Color shall not be darker than Number 4 National Petroleum Association Specifications.

(b) When any additives and inhibitors to be included in shipper's petroleum products are approved by Carrier.

(C) On the condition that Carrier will use due diligence tc transport same to destination with a minimum of commingling and to maintain the identity of each shipment; however, it being impracticable to maintain absolute identity of each inbound Shipment of products, reasonable substitution of gallonage of the same kind of commodity will be permitted.

(d) When shipper has made necessary arrangements to provide facilities to tender such products and deliver same at Carrier's receiving manifold at origin station at pumping rates and pressures as required by Carrier of all shippers.

(e) When shipper has made necessary arrangements to provide facilities at destination station to receive products tendered for transportation at flow rates and pressures as required by Carrier of all shippers. In order to maintain continuous pipeline service consignee at destination shall set receiving line valves and line up receiving manifold in proper position at least one and one-half hours prior to estimated time of delivery.

(f) If products tendered by shipper do not contain corrosion inhibitor compound which is satisfactory to Carder, then Carrier may inject corrosion inhibitor compound in the product to be transported and shipper and consignee will accept delivery of shipments at destination containing portions of the corrosion inhibitor compound.

(g) When free from all liens and charges.

(h) Failure of shipper to Comply with the above conditions may result in Carrier's refusal to accept the entire tender for transportation or to accept a reduced tender in an amount determined by the Carrier to be equitable to all shippers.

ITEM 50
SUBJECT Duty of Carrier
RULES AND REGULATIONS

Carrier shall not be required to transport products except with reasonable diligence, considering the quantity to be

transported, the distance of transportation, safety of operation, and other material factors.

ITEM 60
SUBJECT Tender of Products
RULES AND REGULATIONS

Any shipper desiring pipeline transportation of products under this tariff must, on or before the 15th day of the. month, submit to Carrier a notice of shipment of the quantity of products to be transported during the following month, otherwise Carrier will be under no obligation to accept such products for transportation.

Shippers will be required to schedule their products for delivery into Carrier's receiving tanks or suction manifold at point of origin to meet the cycle within which the product will move. Product shall be available for shipment 24 hours prior to the schedule date for movement into the Carrier's System.

Tenders for transportation of any specified products shall become operative in the order in which the tenders therefor are received. However, since products are pumped in a certain sequence for efficient operation, Carrier reserves the right to specify the sequence of transportation of products. As an incident to the acceptance of any tender, the shipper s shall furnish and pay freight on such buffer material as may be required by Carrier.

ITEM 70
SUBJECT Determination of Volumes
RULES AND REGULATIONS

Products tendered to Carrier at origin station and delivered by Carrier at destination station shall be measured through meters or gauged in tanks and may be tested by a representative of Carrier prior to acceptance for transportation. The shipper at origin station and consignee at

destination station shall have the privilege of being present or represented at the gauging or testing.

Volumes measured at origin and destination stations will be corrected from observed temperatures to sixty degrees (60°) Fahrenheit by the use of factors derived from the applicable ASTM-IP Table 6. "Reduction of Volume to 60° F against API Gravity at 60° F.

ITEM 80
SUBJECT Transportation Charges
RULES AND REGULATIONS

Transportation charges will be assumed and collected at the rates published herein in effect on date of shipment from origin station. Charges will be based on the number of barrels of petroleum products actually delivered at destination as determined in Item 70.

The shipper shall be responsible for payment of all charges applicable to the shipment within 20 days from date of billing and, if required by Carrier, shall prepay all charges or furnish guaranty of payment satisfactory to Carrier. Carrier shall have a lien on all petroleum products accepted from a shipper under this tariff to secure the payment of all charges and obligations of the shipper and may refuse to deliver such products until al! charges and obligations have been paid.

ITEM90
SUBJECT Claims, Suits, Time for Filing
RULES AND REGULATIONS

As a condition precedent to recovery, claims must be filed in writing with Carrier within nine (9) months after reasonable time for delivery has elapsed; and suit shall be instituted against Carrier only within two (2) years and one (1) day from the day when notice in writing is given by Carrier to the clamant that Carrier has disallowed the claim or any part or parts thereof as specified in the notice. Where

claims are not filed or suits are not instituted thereon in accordance with the foregoing provisions, Carrier shall not be liable and such claims will not be paid.

ITEM 100
SUBJECT Liability of Carrier
RULES AND REGULATIONS

While in the possession of the property herein described, the Carrier shall not be liable for any loss or damage or delay caused by the act of God, public enemy, quarantine, authority of law, strikes, riots, fire, floods, or act of default of shipper or owner, or for any other cause not due to the negligence of the Carrier whether similar or dissimilar to the causes herein enumerated; in such cages, the owner shall stand the loss in the same proportion as the amount accepted for transportation and actually in the Carrier's custody bears to the whole of the property of all shippers in the system of the Carrier at the time of such loss and shall be entitled to receive only such portion of his shipment as is left after deducting a due proportion of the loss, as above.

The Carrier will not be liable for discoloration, commingling, contamination, or deterioration of products transported unless such discoloration, commingling, contamination, or deterioration is caused by the negligence of Carrier.

Normal commingling which occurs between batches may be divided as equably as possible among the shippers participating in the batches causing the commingling.

ITEM 110
SUBJECT Pipeage Contracts Required
RULES AND REGULATIONS

Separate pipeage contracts in accord with this tariff and these regulations covering further details may be required of

the proposed shipper before any duty of transportation shall arise.

ITEM 120
SUBJECT Reconsignment
RULES AND REGULATIONS

If no out-of-line movement is required, reconsignment may be made without charge subject to the rules, rates and regulations applicable to the point of final delivery as provided in this tariff.

ITEM 130
SUBJECT Use of Communication Facilities
RULES AND REGULATIONS

Where Carrier maintains private or leased communication facilities, transmission of messages incident to a shipment may be made by Carrier for the shipper without additional charge. However, Carrier assumes no liability for non-delivery of messages away from its offices, for error, for delay in transmission or for interruption of services.

EXPLANATION OF ABBREVIATIONS

Ariz. = Arizona
Cal. = California
FERC = Federal Energy Regulatory Commission
N.M. = New Mexico
Nev. = Nevada
Ore. = Oregon
Tex. = Texas

EXPLANATION OF REFERENCE MARKS

Reference Mark	Explanation
①	Applies only on Petroleum Distillate Fuel Oils.
(N)	New origination

THE END

Supplement No.1 To FERC No.15
(Postpones FERC No.15)

Filed
Office of the Secretary
92 AUG 28 PM 12:18
Federal Energy
Regulatory Commission

SUSPENDED Until 10/2/92
IN I. & S. Docket By Order
IS92-39-000

POSTPONEMENT SUPPLEMENT
SFPP, L.P.
LOCAL PIPELINE TARIFF 8-Y

Applying On
PETROLEUM PRODUCTS

FROM DESIGNATED STATIONS IN
CALIFORNIA, TEXAS AND OREGON
TO DESIGNATED STATIONS IN ARIZONA,
NEW MEXICO, NEVADA AND OREGON

This supplement postpones the effective date of SFPP, L.P. Tariff FERC No. 15, from September 1, 1992 until October 1, 1992.

This carrier certifies that it is fully offering and when requested, impartially providing its obligated services and fully observing all requirements of law and regulations prescribed by the Commission.

NOTICE: The provisions published herein will, if effective, not result in an effect on the quality of the human environment.

Issued on one day's notice pursuant to FERC SpeciaiPermission No. SP92-15-000.

ISSUED: AUGUST 28, 1992
EFFECTIVE: AUGUST 30, 1992

Issued by
Irvin Tools, Jr., President
Santa Fe Pacific Pipelines, Inc.
General Partner of
SFPP, L.P.
888 South Figueroa Street
Los Angeles, California 90017

Supplement No.2 to FERC No.15
(Suspends FERC No.15 and Supplement No.1 To FERC No.15)

Filed
Office of the Secretary
92 OCT -6 AM 11:39
Federal Energy
Regulatory Commission

SUSPENSION SUPPLEMENT
SFPP., L.P.
LOCAL PIPELINE TARIFF 8-Y

Applying On
PETROLEUM PRODUCTS

FROM DESIGNATED STATIONS IN CALIFORNIA, TEXAS AND OREGON TO DESIGNATED STATIONS IN ARIZONA, NEW MEXICO, NEVADA AND OREGON

By order of the Federal Energy Regulatory Commission Oil Pipeline Board dated September 29, 1992 in Docket No. IS92-394-000, SFPP., L.P. Tariff FERC. No.15 and Supplement No. 1 thereto are suspended for one day and made effective October 2, 1992, subject to investigation and refund in Docket No. IS92-39-000.

This carrier certifies that it is fully offering and when requested, impartially providing its obligated services and fully observing all requirements of law and regulations prescribed by the Commission.

NOTICE: The provisions published herein will, if effective, not result in an effect on the quality of the human environment.

Issued under authority of 18 C.F.R. 341.9(k) and in Compliance with order of the Federal Energy Regulatory Commission in Docket No. IS92-39-000 of September 29, 1992.

ISSUED: OCTOBER 6, 1992

Issued by
Irvin Toole, Jr., President
Santa Fe Pacific Pipelines, Inc.
General Partner of SFPP., L.P.
888 South Figueroa Street
Los Angeles, California 90017

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

ORDER ACCEPTING FOR FILING AND SUSPENDING TARIFFS AND TARIFF SUPPLEMENTS, SUBJECT TO INVESTIGATION AND REFUND, AND ESTABLISHING HEARING PROCEDURES

(Issued September 29, 1992)

The Board Orders:

(A) Pursuant to 49 U.S.C. § 15(7) an investigation shall be instituted into the lawfulness of SFPP, L.P.'s FERC Tariff Nos. 15, 16, and 17 and Postponement Supplements No. I related thereto. Pending hearing and decision, SFPP, L.P.'s proposed FERC Tariff

Nos. 15, 16, and 17 and Postponement Supplements No. 1 to FERC Tariff Nos. 15, 16, and 17 are accepted for filing and suspended for one day until October 2, 1992, when the tariffs and supplements shall be permitted to become effective subject to refund.

(B) Pursuant to 18 C.F.R. § 340.1, SFPP, L.P. shall keep accurate account of all amounts received by reason of the instant filing, specifying when, by whom, and in whose behalf such amounts are paid. The accounts shall be in sufficient detail so that refunds with interest can be ordered of any portion of the rates ultimately found unjustified.

(C) Presiding Administrative Law Judge, to be designated by the Chief Administrative Law Judge for that purpose (18 C.F.R. § 375.305) shall convene a prehearing conference in this proceeding to be held in a hearing or conference room of the Federal Energy Regulatory Commission, 810 First Street, N.E., Washington, D.C., 20426. The conference shall be held for the purpose of establishing any procedural dates necessary for the hearing. The Presiding Administrative Law Judge is authorized to conduct further proceedings in accordance with this order and the Rules of Practice and Procedure.

(D) If no answers in opposition to El Paso's and Chevron's Motions to Intervene are filed within 15 days after the issuance of this order, they will become parties to this proceeding at the end of the period pursuant to 18 C.F.R. § 385.1403.

By the Oil Pipeline Board.

FERC No.16
(Cancels FERC. No.13)

Filed
Office of the Secretary
92 JUL 31 PM 2:30
Federal Energy
Regulatory Commission

SUSPENDED Until 10/2/92
IN I. & S. DOCKET
BY ORDER
IS92-39-000

SFPP, L.P.
Local Pipeline Tariff 16-D
(Cancels SFPP, L.P. Tariff 16-C)

Applying On
GASOLINES
PETROLEUM DISTILLATE FUEL OILS
(except turbine fuel).

FROM STATIONS AT	
Watson, Cal.	
(N) East Hynes, Cal.	
Norwalk, Cal.	
TO STATIONS AT	Rate in Cents Per Band
Tucson, Ariz.	154.3

SUBJECT TO RULES AND REGULATIONS SHOWN IN ITEMS 10 to 130 INCLUSIVE.

NOTICE

For explanation of reference marks see concluding page of this tariff.

This carrier certifies it is fully offering and when requested, impartially providing its obligated services and fully observing

all requirements of law and regulations prescribed by the Commission.

NOTICE — The provisions published herein will, if effective, not result in an effect on the quality of the human environment.

ISSUED: JULY 31, 1992
EFFECTIVE: SEPTEMBER 1, 1992

Issued by
Irvin Toole, Jr., President
Santa Fe Pacific Pipelines, Inc.
General Partner of SFPP., L.P.
888 South Figueroa Street
Los Angeles, California 90017

ITEM 10
SUBJECT Definitions
RULES AND REGULATIONS

Term "Barrel" as used herein refers to forty-two (42) gallons, United States measurement, at 60 degrees (60°) Fahrenheit.

Term "Carrier" as used hereto refers to SFPP, L.P.

Term "Products" as used herein refers to petroleum products described in Item 20.

ITEM 2O
SUBJECT Articles on Which Rates Apply
RULES AND REGULATIONS

Rates published in this tariff apply on the following petroleum products:

Gasolines

Petroleum Distillate Fuel Oils.

ITEM30
SUBJECT Minimum Tender and Delivery Requirements
RULES AND REGULATIONS

The minimum quantity of any one product of quality and specifications described herein which wall be accepted at one point of origin from one shipper shall be 5000 barrels, except at Watson and Norwalk, California, where the minimum quantity shall be 10,000 barrels, and at Portland, Oregon where the minimum quantity shall be 2,500 barrels.

The minimum quantity which will be delivered at any destination station or intermediate storage shall be 2,500 barrels, except at Colton, California, where the minimum quantity delivered shall be 5,000 barrels.

ITEM 35
SUBJECT Proration of Pipeline Capacity
RULES AND REGULATIONS

When more petroleum product is offered by shippers to the carrier under this tariff than can be currently transported within the period covered by such offers, petroleum products offered by each shipper for : transportation will be transported in such quantities and at such times to the limit of carrier's capacity in a manner determined by carrier to be equitable to all shippers.

ITEM 4O
SUBJECT Acceptance of Products
RULES AND REGULATIONS

Products will be accepted for transportation:

(a) At such time as .products of compatible quality and specifications are currently being transported from receiving point to destination. Color shall not be darker than Number 4 National Petroleum Association Specifications.

(b) When any additives and inhibitors to be included in shipper's petroleum products are approved by Carrier.

(c) On the condition that Carrier will use due diligence to transport same to destination with a minimum of commingling and to maintain the identity of each shipment; however, it being impracticable to maintain absolute identity of each inbound Shipment of products, reasonable substitution of gallonage of the same kind of commodity will be permitted.

(d) When shipper has made necessary arrangements to provide facilities to tender such products and deliver same at Carrier's receiving manifold at origin station at pumping rates and pressures as required by Carrier of all shippers.

(e) When shipper has made necessary arrangements to provide facilities at destination station to receive products tendered for transportation at flow rates and pressures as required by Carrier of all shippers. In order to maintain continuous pipeline service consignee at destination shall set receiving line valves and line up receiving manifold in proper position at least one and one-half hours prior to estimated time of delivery.

(f) If products tendered by shipper do not contain corrosion inhibitor compound which is satisfactory to Carder, then Carrier may inject corrosion inhibitor compound in the product to be transported and shipper and consignee will accept delivery of shipments at destination containing portions of the corrosion inhibitor compound.

(g) When free from all liens and charges.

(h) Failure of shipper to Comply with the above conditions may result in Carrier's refusal to accept the entire tender for transportation or to accept a reduced tender in an amount determined by the Carrier to be equitable to all shippers.

ITEM 50
SUBJECT Duty of Carrier
RULES AND REGULATIONS

Carrier shall not be required to transport products except with reasonable diligence, considering the quantity to be

transported, the distance of transportation, safety of operation, and other material factors.

ITEM 60
SUBJECT Tender of Products
RULES AND REGULATIONS

Any shipper desiring pipeline transportation of products under this tariff must, on or before the 15th day of the. month, submit to Carrier a notice of shipment of the quantity of products to be transported during the following month, otherwise Carrier will be under no obligation to accept such products for transportation.

Shippers will be required to schedule their products for delivery into Carrier's receiving tanks or suction manifold at point of origin to meet the cycle within which the product will move. Product shall be available for shipment 24 hours prior to the schedule date for movement into the Carrier's System.

Tenders for transportation of any specified products shall become operative in the order in which the tenders therefor are received. However, since products are pumped in a certain sequence for efficient operation, Carrier reserves the right to specify the sequence of transportation of products. As an incident to the acceptance of any tender, the shipper s shall furnish and pay freight on such buffer material as may be required by Carrier.

ITEM 70
SUBJECT Determination of Volumes
RULES AND REGULATIONS

Products tendered to Carrier at origin station and delivered by Carrier at destination station shall be measured through meters or gauged in tanks and may be tested by a representative of Carrier prior to acceptance for transportation. The shipper at origin station and consignee at

destination station shall have the privilege of being present or represented at the gauging or testing.

Volumes measured at origin and destination stations will be corrected from observed temperatures to sixty degrees (60°) Fahrenheit by the use of factors derived from the applicable ASTM-IP Table 6. "Reduction of Volume to 60° F against API Gravity at 60° F.

ITEM 80
SUBJECT Transportation Charges
RULES AND REGULATIONS

Transportation charges will be assumed and collected at the rates published herein in effect on date of shipment from origin station. Charges will be based on the number of barrels of petroleum products actually delivered at destination as determined in Item 70.

The shipper shall be responsible for payment of all charges applicable to the shipment within 20 days from date of billing and, if required by Carrier, shall prepay all charges or furnish guaranty of payment satisfactory to Carrier. Carrier shall have a lien on all petroleum products accepted from a shipper under this tariff to secure the payment of all charges and obligations of the shipper and may refuse to deliver such products until al! charges and obligations have been paid.

ITEM90
SUBJECT Claims, Suits, Time for Filing
RULES AND REGULATIONS

As a condition precedent to recovery, claims must be filed in writing with Carrier within nine (9) months after reasonable time for delivery has elapsed; and suit shall be instituted against Carrier only within two (2) years and one (1) day from the day when notice in writing is given by Carrier to the clamant that Carrier has disallowed the claim or any part or parts thereof as specified in the notice. Where claims are not

filed or suits are not instituted thereon in accordance with the foregoing provisions, Carrier shall not be liable and such claims will not be paid.

ITEM 100
SUBJECT Liability of Carrier
RULES AND REGULATIONS

While in the possession of the property herein described, the Carrier shall not be liable for any loss or damage or delay caused by the act of God, public enemy, quarantine, authority of law, strikes, riots, fire, floods, or act of default of shipper or owner, or for any other cause not due to the negligence of the Carrier whether similar or dissimilar to the causes herein enumerated; in such cages, the owner shall stand the loss in the same proportion as the amount accepted for transportation and actually in the Carrier's custody bears to the whole of the property to all shippers in the system of the Carrier at the time of such loss and shall be entitled to receive only such portion of his shipment as is left after deducting a due proportion of the loss, as above.

The Carrier will not be liable for discoloration, commingling, contamination, or deterioration of products transported unless such discoloration, commingling, contamination, or deterioration is caused by the negligence of Carrier.

Normal commingling which occurs between batches may be divided as equably as possible among the shippers participating in the batches causing
the commingling.

ITEM 110
SUBJECT Pipeage Contracts Required
RULES AND REGULATIONS

Separate pipeage contracts in accord with this tariff and these regulations covering further details may be required of

the proposed shipper before any duty of transportation shall arise.

ITEM 120
SUBJECT Reconsignment
RULES AND REGULATIONS

If no out-of-line movement is required, reconsignment may be made without charge subject to the rules, rates and regulations applicable to the point of final delivery as provided in this tariff.

ITEM 130
SUBJECT Use of Communication Facilities
RULES AND REGULATIONS

Where Carrier maintains private or leased communication facilities, transmission of messages incident to a shipment may be made by Carrier for the shipper without additional charge. However, Carrier assumes no liability for non-delivery of messages away from its offices, for error, for delay in transmission or for interruption of services.

EXPLANATION OF ABBREVIATIONS

Ariz. = Arizona
Cal. = California
FERC = Federal Energy Regulatory Commission

EXPLANATION OF REFERENCE MARKS

Reference Mark	Explanation
(N)	New origination

THE END

Supplement No.1 To FERC No.16
(Postpones FERC. No. 16)

Filed
Office of the Secretary
92 AUG 28 PM 12:18
Federal Energy
Regulatory Commission

SUSPENDED Until 10/2/92
IN I. & S. DOCKET
BY ORDER
IS92-39-000

SFPP., L.P..
LOCAL PIPELINE TARIFF 16-D

Applying On
GASOLINES
PETROLEUM DISTILLATE FUEL OILS
(except turbine fuel).

FROM STATIONS AT WATSON, EAST HYNES AND NORWALK, CALIFORNIA
TO STATIONS AT TUCSON, ARIZONA

This supplement postpones the effective date of SFPP, L.P. Tariff FERC No. 16, from September 1, 1992 until October 1, 1992.

This carrier certifies that it is fully offering and when requested, impartially providing its obligated services and fully observing all requirements of law and regulations prescribed by the Commission.

NOTICE: The provisions published herein will, if effective, not result in an effect on the quality of the human environment.

Issued on one day's notice pursuant to FERC Special Permission No. SP92-15-000.

ISSUED: AUGUST 28, 1992
EFFECTIVE: AUGUST 30, 1992

Issued by
Irvin Toole, Jr., President
Santa Fe Pacific Pipelines, Inc.
General Partner of SFPP., L.P.
888 South Figueroa Street
Los Angeles, California 90017

Supplement No.2 To FERC No.16
(Suspends FERC No.16 and Supplement No.1 To FERC No.16)

Filed
Office of the Secretary
92 OCT -6 AM 11:39
Federal Energy
Regulatory Commission

SUSPENSION SUPPLEMENT
SFPP., L.P.
LOCAL PIPELINE TARIFF 16-D

Applying On
GASOLINES
PETROLEUM DISTILLATE FUEL OILS
(except turbine fuel).

FROM STATIONS AT WATSON, EAST HYNES AND NORWALK, CALIFORNIA
TO STATIONS AT TUCSON, ARIZONA

By order of the Federal Energy Regulatory Commission Oil Pipeline Board dated September 29, 1992 in Docket No. IS92-39-000,SFPP, L.P. Tariff FERC No. 16 and Supplement No. I thereto are suspended for one day and made effective October 2, 1992, subject to investigation and refund in Docket No. IS92-39-000.

This carrier certifies that it is fully offering and when requested, impartially providing its obligated services and fully observing all requirements of law and regulations prescribed by the Commission.

NOTICE: The provisions published herein will, if effective, not result in an effect On the quality of the human environment.

Issued under authority of 18 C.F.R. 341.9(k) and in compliance with order of the Federal Energy Regulatory Commission in Docket No. IS92-39-000 Of September 29, 1992.

ISSUED: OCTOBER 6, 1992

Issued by
Irvin Toole, Jr., President
Santa Fe Pacific Pipelines, Inc.
General Partner of SFPP., L.P.
888 South Figueroa Street
Los Angeles, California 90017

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

ORDER ACCEPTING FOR FILING AND SUSPENDING TARIFFS AND TARIFF SUPPLEMENTS, SUBJECT TO INVESTIGATION AND REFUND, AND ESTABLISHING HEARING PROCEDURES

(Issued September 29, 1992)

The Board Orders:

(A) Pursuant to 49 U.S.C. § 15(7) an investigation shall be instituted into the lawfulness of SFPP, L.P.'s FERC. Tariff Nos. 15, 16, and 17 and Postponement Supplements No. 1 related thereto. Pending hearing and decision, SFPP, L.P.'s proposed FERC Tariff

Nos. 15, 16, and 17 and Postponement Supplements No. 1 to FERC Tariff Nos. 15, 16, and 17 are accepted for filing and suspended for one day until October 2, 1992, when the tariffs and supplements shall be permitted to become effective subject to refund.

(B) Pursuant to 18 C.F.R. § 340.1, SFPP, L.P. shall keep accurate account of all amounts received by reason of the instant filing, specifying when, by whom, and in whose behalf such amounts are paid. The accounts shall be in sufficient detail so that refunds with interest can be ordered of any portion of the rates ultimately found unjustified.

(C) A Presiding Administrative Law Judge, to be designated by the Chief Administrative Law Judge for that purpose (18 C.F.R. § 375.305) shall convene a prehearing conference in this proceeding to be held in a hearing or conference room of the Federal Energy Regulatory Commission, 810 First Street, N.E., Washington, D.C., 20426. The prehearing conference shall be held for the purpose of establishing any procedural dates necessary for the hearing. The Presiding Administrative Law Judge is authorized to conduct further proceedings in accordance with this order and the Rules of Practice and Procedure.

(D) If no answers in opposition to El Paso's and Chevron's Motions to intervene are filed within 15 days after the issuance of this Order, they will become parties to this proceeding at the end of the period pursuant to 18 C.F.R. § 385.1403.

By the Oil Pipeline Board.

FERC No.17
(Cancels FERC No.14)

Filed
Office of the Secretary
92 JUL 31 PM 2:30
Federal Energy
Regulatory Commission

SUSPENDED Until 10/2/92
IN I. & S. DOCKET
BY ORDER
IS92-39-000

SFPP., L.P.
PIPELINE TARIFF 13-H
(Cancels SFPP, L.P. Tariff 13-G)

Applying On
PETROLEUM PRODUCTS
As Defined Herein

FROM STATIONS AT
Watson, Cal.
(N) East Hynes, Cal.
Norwalk, Cal.

TO STATIONS AT	Rate in Cents Per Barrel
CALNEV Pipe Line Co., Colton, Cal.	24.6

THIS TARIFF APPLIES TO INTERSTATE TRAFFIC ONLY

SUBJECT TO RULES AND REGULATIONS SHOWN IN ITEMS 5 to 130 INCLUSIVE.

NOTICE

For explanation of reference marks see concluding page of this tariff.

This carrier certifies it is fully offering and when requested, impartially providing its obligated services and fully observing all requirements of Law and regulations prescribed by the Commission.

NOTICE — The provisions herein will, if effective, not result in an effect on the quality of the human environment.

ISSUED: JULY 3, 1992
EFFECTIVE: SEPTEMBER 1, 1992

Issued by
Irvin Toole, Jr., President
Santa Fe Pacific Pipelines, Inc.
General Partner of SFPP., L.P.
888 South Figaro Street
Los Angeles, California 90017

ITEM 10
SUBJECT Definitions
RULES AND REGULATIONS

Term "Barrel" as used herein refers to forty-two (42) gallons, United States measurement, at 60 degrees (60) Fahrenheit.

Term "Carrier" as used hereto refers to SFPP, L.P.

Term "Products" as used herein refers to petroleum products described in Item 20.

ITEM 2O
SUBJECT Articles on Which Rates Apply
RULES AND REGULATIONS

Rates published in this tariff apply on the following petroleum products:

Gasolines

Petroleum Distillate Fuel Oils.

ITEM30
SUBJECT Minimum Tender and Delivery Requirements
RULES AND REGULATIONS

The minimum quantity of any one product of quality and specifications described herein which will be accepted at one point of origin from one shipper shall be 10,000 barrels.

The minimum quantity which will be delivered at any destination station or intermediate storage shall be 5,000 barrels.

ITEM 35
SUBJECT Proration of Pipeline Capacity
RULES AND REGULATIONS

When more petroleum product is offered by shippers to the carrier under this tariff than can be currently transported within the period covered by such offers, petroleum products offered by each shipper for : transportation will be transported in such quantities and at such times to the limit of carrier's capacity in a manner determined by carrier to be equitable to all shippers.

ITEM 4O
SUBJECT Acceptance of Products
RULES AND REGULATIONS

Products will be accepted for transportation:

(a) At such time as products of compatible quality and specifications are currently being transported from receiving point to destination. Color shall not be darker than Number 4 National Petroleum Association Specifications.

(b) When any additives and inhibitors to be included in shipper's petroleum products are approved by Carrier.

(c) On the condition that Carrier will use due diligence to transport same to destination with a minimum of commingling and to maintain the identity of each shipment; however, it being impracticable to maintain absolute identity of each

inbound Shipment of products, reasonable substitution of gallinae of the same kind of commodity will be permitted.

(d) When shipper has made necessary arrangements to provide facilities to tender such products and deliver same at Carrier's receiving manifold at origin station at pumping rates and pressures as required by Carrier of all shippers.

(e) When shipper has made necessary arrangements to provide facilities at destination station to receive products tendered for transportation at flow rates and pressures as required by Carrier of all shippers. In order to maintain continuous pipeline service consignee at destination shall set receiving line valves and line up receiving manifold in proper position at least one and one-half hours prior to estimated time of delivery.

(f) If products tendered by shipper do not contain corrosion inhibitor compound which is satisfactory to Calder, then Carrier may inject corrosion inhibitor compound in the product to be transported and shipper and consignee will accept delivery of shipments at destination containing portions of the corrosion inhibitor compound.

(g) When free from all liens and charges.

(h) Failure of shipper to Comply with the above conditions may result in Carrier's refusal to accept the entire tender for transportation or to accept a reduced tender in an amount determined by the Carrier to be equitable to all shippers.

ITEM 50
SUBJECT Duty of Carrier
RULES AND REGULATIONS

Carrier shall not be required to transport products except with reasonable diligence, considering the quantity to be transported, the distance of transportation, safety of operation, and other material factors.

ITEM 60
SUBJECT Tender of Products
RULES AND REGULATIONS

Any shipper desiring pipeline transportation of products under this tariff must, on or before the 15th day of the. month, submit to Carrier a notice of shipment of the quantity of products to be transported during the following month, otherwise Carrier will be under no obligation to accept such products for transportation.

Shippers will be required to schedule their products for delivery into Carrier's receiving tanks or suction manifold at point of origin to meet the cycle within which the product will move. Product shall be available for shipment 24 hours prior to the schedule date for movement into the Carrier's System.

Tenders for transportation of any specified products shall become operative in the order in which the tenders therefor are received. However, since products are pumped in a certain sequence for efficient operation, Carrier reserves the right to specify the sequence of transportation of products. As an incident to the acceptance of any tender, the shipper s shall furnish and pay freight on such buffer material as may be required by Carrier.

ITEM 70
SUBJECT Determination of Volumes
RULES AND REGULATIONS

Products tendered to Carrier at origin station and delivered by Carrier at destination station shall be measured through meters or gauged in tanks and may be tested by a representative of Carrier prior to acceptance for transportation. The shipper at origin station and consignee at destination station shall have the privilege of being present or represented at the gauging or testing.

Volumes measured at origin and destination stations will be corrected from observed temperatures to sixty degrees

(60°) Fahrenheit by the use of factors derived from the applicable ASTM-IP Table 6. "Reduction of Volume to 60° F against API Gravity at 60° F.

ITEM 80
SUBJECT Transportation Charges
RULES AND REGULATIONS

Transportation charges will be assumed and collected at the rates published herein in effect on date of shipment from origin station. Charges will be based on the number of barrels of petroleum products actually delivered at destination as determined in Item 70.

The shipper shall be responsible for payment of all charges applicable to the shipment within 20 days from date of billing and, if required by Carrier, shall prepay all charges or furnish guaranty of payment satisfactory to Carrier. Carrier shall have a lien on all petroleum products accepted from a shipper under this tariff to secure the payment of all charges and obligations of the shipper and may refuse to deliver such products until all charges and obligations have been paid.

ITEM90
SUBJECT Claims, Suits, Time for Filing
RULES AND REGULATIONS

As a condition precedent to recovery, claims must be filed in writing with Carrier within nine (9) months after reasonable time for delivery has elapsed; and suit shall be instituted against Carrier only within two (2) years and one (1) day from the day when notice in writing is given by Carrier to the clamant that Carrier has disallowed the claim or any part or parts thereof as specified in the notice. Where claims are not filed or suits are not instituted thereon in accordance with the foregoing provisions, Carrier shall not be liable and such claims will not be paid.

ITEM 100
SUBJECT Liability of Carrier
RULES AND REGULATIONS

While in the possession of the property herein described, the Carrier shall not be liable for any loss or damage or delay caused by the act of God, public enemy, quarantine, authority of law, strikes, riots, fire, floods, or act of default of shipper or owner, or for any other cause not due to the negligence of the Carrier whether similar or dissimilar to the causes herein enumerated; in such cages, the owner shall stand the loss in the same proportion as the amount accepted for transportation and actually in the Carrier's custody bears to the whole of the property to all shippers in the system of the Carrier at the time of such loss and shall be entitled to receive only such portion of his shipment as is left after deducting a due proportion of the loss, as above.

The Carrier will not be liable for discoloration, commingling, contamination, or deterioration of products transported unless such discoloration, commingling, contamination, or deterioration is caused by the negligence of Carrier.

Normal commingling which occurs between batches may be divided as equably as possible among the shippers participating in the batches causing
the commingling.

ITEM 110
SUBJECT Pipeage Contracts Required
RULES AND REGULATIONS

Separate pipeage contracts in accord with this tariff and these regulations covering further details may be required of the proposed shipper before any duty of transportation shall arise.

ITEM 120
SUBJECT Reconsignment
RULES AND REGULATIONS

If no out-of-line movement is required, reconsignment may be made without charge subject to the rules, rates and regulations applicable to the point of final delivery as provided in this tariff.

ITEM 130
SUBJECT Use of Communication Facilities
RULES AND REGULATIONS

Where Carrier maintains private or leased communication facilities, transmission of messages incident to a shipment may be made by Carrier for the shipper without additional charge. However, Carrier assumes no liability for non-delivery of messages away from its offices, for error, for delay in transmission or for interruption of services.

EXPLANATION OF ABBREVIATIONS

Cal. = California
FERC = Federal Energy Regulatory Commission

EXPLANATION OF REFERENCE MARKS

Reference Mark	Explanation
(N)	New origination

THE END

Supplement No.1 to FERC No.17
(Postpones FERC No.17)

Filed
Office of the Secretary
92 AUG 20 PM 12:18
Federal Energy
Regulatory Commission

SUSPENDED Until 10/2/92
IN I. & S. Docket
BY ORDER
IS92-39-000

SFPP., L.P.
POSTPONEMENT SUPPLEMENT
LOCAL PIPELINE TARIFF 13-H

Applying On
PETROLEUM PRODUCTS

FROM STATIONS AT WATSON, EAST HYNES AND NORWALK, CALIFORNIA TO CALNEV PIPE LINE CO., COLTON, CALIFORNIA (INTERSTATE TRAFFIC ONLY)

This supplement postpones the effective date of SFPP, L.P. Tariff FERC No. 17, from September 1, 1992 until October 1, 1992.

This carrier certifies that it is fully offering and when requested, impartially providing its obligated services and fully observing all requirements of law and regulations prescribed by the Commission.

NOTICE: The provisions published herein will, if effective, not result in an effect on the quality of the human environment.

Issued on one day's notice pursuant to
FERC Special Permission No. SP92-15-000.

ISSUED: AUGUST 28, 1992
EFFECTIVE: AUGUST 30, 1992

Issued by
Irvin Toole, Jr., President
Santa Fe Pacific Pipelines, Inc.
General Partner of SFPP., L.P.
888 South Figueroa Street
Los Angeles, California 90017

Supplement No.2 To FERC No.17
(Suspends FERC No.17 and Supplement No.1 to FERC. No.17)

Filed
Office of the Secretary
92 OCT -6 AM 11:39
Federal Energy
Regulatory Commission

SFPP., L.P.
LOCAL PIPELINE TARIFF 13-H

Applying On
PETROLEUM PRODUCTS

By order of the Federal Energy Regulatory Commission OH Pipeline Board dated September 29, 1992 in Docket No. IS92-39-000, SFPP., L.P. Tariff FERC No. 17 and Supplement No. 1 thereto are suspended for one day and made effective October 2, 1992, subject to investigation and refund in Docket No. IS92-39-000.

This carrier certifies that it is fully offering and when requested, impartially providing its obligated services and fully observing all requirements of law and regulation prescribed by the Commission.

NOTICE: The provisions published herein will, if effective, not result in an effect on the quality of the human environment.

Issued under authority of 18 C.F.R. 341.9(k) and in Compliance with order of the Federal Energy Regulatory

Commission in Docket No. IS92-39-000 of September 29, 1992.

ISSUED: OCTOBER 6, 1992

Issued by
Irvin Toole, Jr., President
Santa Fe Pacific Pipelines, Inc.
General Partner of SFPP., L.P.
888 South Figueroa Street
Los Angeles, California 90017

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

ORDER ACCEPTING FOR FILING AND SUSPENDING TARIFFS AND TARIFF SUPPLEMENTS, SUBJECT TO INVESTIGATION AND REFUND, AND ESTABLISHING HEARING PROCEDURES

(Issued September 29, 1992)

The Board Orders:

(A) Pursuant to 49 U.S.C. § 15(7) an investigation shall be instituted into the lawfulness of SFPP, L.P.'s FERC Tariff Nos. 15, 16, and 17 and Postponement Supplements No. 1 related thereto Pending hearing and decision, SFPP, L.P.'s proposed FERC Tariff Nos. 15, 16, and 17 and Postponement Supplements No. 1 to FERC Tariff Nos. 15, 16, and 17 are accepted for filing and suspended for one day until October 2, 1992, when the tariffs and supplements shall be permitted to become effective subject to retired.

(B) Pursuant to 18 C.F.R. § 340.1, SFPP, L.P. shall keep accurate account of all amounts received by reason of the instant filing, specifying when, by whom, and in whose behalf such amounts are paid. The accounts shall be in sufficient detail so that refunds with interest can be ordered of any portion of the rates ultimately found unjustified.

(C) A Presiding Administrative Law Judge, to be designated by the Chief Administrative Law Judge for that purpose (18 C.F.R. § 375.305) shall convene a prehearing conference in this proceeding to be held in a hearing or conference room of the Federal Energy Regulation Commission, 810 First Street, N.E. Washington, D.C., 2O426. The prehearing conference shall be held for the purpose of establishing any procedural dates necessary for the hearing. The Presiding Administrative Law Judge is authorized to conduct further proceedings in accordance with this order and the Rules of Practice and Procedure.

(D) If no answers in opposition to El Paso's and Chevron's Motions to Intervene are film within 15 days after the issuance of this order, they will become parties to this proceeding at the end of the period pursuit to 18 C.F.R. § 385.1403.

By the Oil Pipeline Board.

APPENDIX H

RELEVANT STATUTORY PROVISIONS

49 USC APPENDIX - TRANSPORTATION Sec. 15

CHAPTER 1

In force on January 2, 1991

Sec. 15. Repealed. Pub. L. 95-473, Sec. 4(b), (c), Oct. 17, 1978, 92 Stat. 1466, 1470; Pub. L. 96-258, Sec. 3(b), June 3, 1980, 94 Stat. 427.

Section repealed subject to an exception related to transportation of oil by pipeline. Section 401 of Pub. L. 95-607, which amended par. (8)(c) and (d) of this section subsequent to the repeal of this section by Pub. L. 95-473, was repealed by Pub. L. 96-258, effective July 1, 1980, as provided by section 3(c) of Pub. L. 96-258. For disposition of this section in revised Title 49, Transportation, see Table at beginning of Title 49. See, also, notes following Table.

Prior to repeal, section read as follows:

Sec. 15. Determination of rates, routes, etc.; routing of traffic; disclosures, etc.

(1) Commission empowered to determine and prescribe rates, classifications, etc.

Whenever, after full hearing, upon a complaint made as provided in section 13 of this Appendix, or after full hearing under an order for investigation and hearing made by the Commission on its own initiative, either in extension of any pending complaint or without any complaint whatever, the Commission shall be of opinion that any individual or joint rate, fare, or charge whatsoever demanded, charged, or collected by any common carrier or carriers subject to this chapter for the transportation of persons or property, as defined in section 1 of this Appendix, or that any individual or joint classification, regulation, or practice whatsoever of such carrier or carriers subject to the provisions of this chapter, is or will be unjust or unreasonable or unjustly discriminatory or unduly preferential or prejudicial, or otherwise in violation of any of the provisions of this chapter, the Commission is authorized and empowered to determine and prescribe what will be the just and reasonable individual or joint rate, fare, or charge, or rates, fares, or charges, to be thereafter observed in such case, or the maximum or minimum, or maximum and minimum, to be charged, and what individual or joint classification, regulation, or practice is or will be just, fair, and reasonable, to be thereafter followed, and to make an order that the carrier or carriers shall cease and desist from such violation to the extent to which the Commission finds that the same does or will exist, and shall not thereafter publish, demand, or collect any rate, fare, or charge for such transportation other than the rate, fare, or charge so prescribed, or in excess of the maximum or less than the minimum so prescribed, as the case may be, and shall adopt the classification and shall conform to and observe the regulation or practice so prescribed.

(2) Orders of Commission

Except as otherwise provided in this chapter, all orders of the Commission, other than orders for the payment of money, shall take effect within such reasonable time as the Commission may prescribe. Such orders shall continue in force until its further order, or for a specified period of time, according as shall be prescribed in the order, unless the same shall be suspended or modified or set aside by the Commission, or be suspended or set aside by a court of competent jurisdiction.

(3) Establishment of through routes, joint classifications, joint rates, fares, etc.

The Commission may, and it shall whenever deemed by it to be necessary or desirable in the public interest, after full hearing upon complaint or upon its own initiative without complaint, establish through routes, joint classifications, and joint rates, fares, or charges, applicable to the transportation of passengers or property by carriers subject to this chapter, or by carriers by railroad subject to this chapter and common carriers by water subject to chapter 12 of this Appendix, or the maxima or minima, or maxima and minima, to be charged, and the divisions of such rates, fares, or charges as hereinafter provided, and the terms and conditions under which such through routes shall be operated. The Commission shall not, however, establish any through route, classification, or practice, or any rate, fare, or charge, between street electric passenger railways not engaged in the general business of transporting freight in addition to their passenger and express business, and railroads of a different character. If any tariff or schedule canceling any through route or joint rate, fare, charge, or classification, without the consent of all carriers parties thereto or authorization by the

Commission, is suspended by the Commission for investigation, the burden of proof shall be upon the carrier or carriers proposing such cancellation to show that it is consistent with the public interest, without regard to the provisions of paragraph (4) of this section. With respect to carriers by railroad, in determining whether any such cancellation or proposed cancellation involving any common carrier by railroad is consistent with the public interest, the Commission shall, to the extent applicable, (a) compare the distance traversed and the average transportation time and expense required using the through route, and the distance traversed and the average transportation time and expense required using alternative routes, between the points served by such through route, (b) consider any reduction in energy consumption which may result from such cancellation, and (c) take into account the overall impact of such cancellation on the shippers and carriers who are affected thereby.

(4) Through routes to embrace entire length of railroad; temporary through routes

In establishing any such through route the Commission shall not (except as provided in section 3 of this Appendix, and except where one of the carriers is a water line) require any carrier by railroad, without its consent, to embrace in such route substantially less than the entire length of its railroad and of any intermediate railroad operated in conjunction and under a common management or control therewith, which lies between the termini of such proposed through route, (a) unless such inclusion of lines would make the through route unreasonably long as compared with another practicable through route which could otherwise be established, or (b) unless the Commission finds that the through route proposed to be established is needed in order to

provide adequate, and more efficient or more economic, transportation:

Provided, however, That in prescribing through routes the Commission shall, so far as is consistent with the public interest, and subject to the foregoing limitations in clauses (a) and (b) of this paragraph, give reasonable preference to the carrier by railroad which originates the traffic. No through route and joint rates applicable thereto shall be established by the Commission for the purpose of assisting any carrier that would participate therein to meet its financial needs. In time of shortage of equipment, congestion of traffic, or other emergency declared by the Commission, it may (either upon complaint or upon its own initiative without complaint, at once, if it so orders, without answer or other formal pleadings by the interested carrier or carriers, and with or without notice, hearing, or the making or filing of a report, according as the Commission may determine)establish temporarily such through routes as in its opinion are necessary or desirable in the public interest.

(5) Transportation of livestock in carload lots; services included

Transportation wholly by railroad of ordinary livestock in carload lots destined to or received at public stockyards shall include all necessary service of unloading and reloading en route, delivery at public stockyards of inbound shipments into suitable pens, and receipt and loading at such yards of outbound shipments, without extra charge therefor to the shipper, consignee, or owner, except in cases where the unloading or reloading en route is at the request of the shipper, consignee, or owner, or to try an intermediate market, or to comply with quarantine regulations. The Commission may prescribe or approve just and reasonable

rules governing each of such excepted services. Nothing in this paragraph shall be construed to affect the duties and liabilities of the carriers existing on February 28, 1920, by virtue of law respecting the transportation of other than ordinary livestock, or the duty of performing service as to shipments other than those to or from public stockyards.

(6) Commission to establishment just divisions of joint rates, fares, or charges; adjustments; procedures applicable

(a) Whenever, after full hearing upon complaint or upon its own initiative, the Commission is of opinion that the divisions of joint rates, fares, or charges, applicable to the transportation of passengers or property, are or will be unjust, unreasonable, inequitable, or unduly preferential or prejudicial as between the carriers parties thereto (whether agreed upon by such carriers, or any of them, or otherwise established), the Commission shall by order prescribe the just, reasonable, and equitable divisions thereof to be received by the several carriers, and in cases where the joint rate, fare, or charge was established pursuant to a finding or order of the Commission and the divisions thereof are found by it to have been unjust, unreasonable, or inequitable, or unduly preferential or prejudicial, the Commission may also by order determine what (for the period subsequent to the filing of the complaint or petition or the making of the order of investigation) would have been the just, reasonable and equitable divisions thereof to be received by the several carriers, and require adjustment to be made in accordance therewith. In so prescribing and determining the divisions of joint rates, fares, and charges, the Commission shall give due consideration, among other things, to the efficiency with which the carriers concerned are operated, the amount of revenue required to pay their respective operating expenses, taxes, and a fair return on their railway property held for and

used in the service of transportation, and the importance to the public of the transportation services of such carriers; and also whether any particular participating carrier is an originating, intermediate, or delivering line, and any other fact or circumstance which would ordinarily, without regard to the mileage haul, entitle one carrier to a greater or less proportion than another carrier of the joint rate, fare, or charge.

(b) Notwithstanding any other provision of law, the Commission shall, within 180 days after February 5, 1976, establish, by rule, standards and procedures for the conduct of proceedings for the adjustment of divisions of joint rates or fares (whether prescribed by the Commission or otherwise) in accordance with the provisions of this paragraph. The Commission shall issue a final order in all such proceedings within 270 days after the submission to the Commission of a case. If the Commission is unable to issue such a final order within such time, it shall issue a report to the Congress setting forth the reasons for such inability.

(c) All evidentiary proceedings conducted pursuant to this paragraph shall be completed, in a case brought upon a complaint, within 1 year following the filing of the complaint, or, in a case brought upon the Commission's initiative, within 2 years following the commencement of such proceeding, unless the Commission finds that such a proceeding must be extended to permit a fair and expeditious completion of the proceeding. If the Commission is unable to meet any such time requirement, it shall issue a report to the Congress setting forth the reasons for such inability.

(d) Whenever a proceeding for the adjustment of divisions of joint rates or fares (whether prescribed by the Commission or otherwise established) is commenced by the filing of a complaint with the Commission, the complaining

carrier or carriers shall (i) attach thereto all of the evidence in support of their position, and (ii) during the course of such proceeding, file only rebuttal or reply evidence unless otherwise directed by order of the Commission. Upon receipt of a notice of intent to file a complaint pursuant to this paragraph, the Commission shall accord, to party filing such notice, the same right to discovery that would be accorded to a party filing a complaint pursuant to this paragraph.

(7) Commission to determine lawfulness of new rates; suspension; refunds; nonapplicability to common carriers by railroad subject to chapter

Whenever there shall be filed with the Commission any schedule stating a new individual or joint rate, fare, or charge, or any new individual or joint classification, or any new individual or joint regulation or practice affecting any rate, fare, or charge, the Commission shall have, and it is given, authority, either upon complaint or upon its own initiative without complaint, at once, and if it so orders without answer or other formal pleading by the interested carrier or carriers, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, fare, charge, classification, regulation, or practice; and pending such hearing and the decision thereon the Commission, upon filing with such schedule and delivering to the carrier or carriers affected thereby a statement in writing of its reasons for such suspension, may from time to time suspend the operation of such schedule and defer the use of such rate, fare, charge, classification, regulation, or practice, but not for a longer period than seven months beyond the time when it would otherwise go into effect; and after full hearing, whether completed before or after the rate, fare, charge, classification, regulation, or practice goes into effect, the Commission may make such order with reference thereto as would be proper in

a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made within the period of suspension, the proposed change of rate, fare, charge, classification, regulation, or practice shall go effect at the end of such period; but in case of a proposed increased rate or charge for or in respect to the transportation of property, the Commission may by order require the interested carrier or carriers to keep accurate account in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts are paid, and upon completion of the hearing and decision may by further order require the interested carrier or carriers to refund, with interest, to the persons in whose behalf such amounts were paid, such portion of such increased rates or charges as by its decision shall be found not justified. At any hearing involving a change in a rate, fare, charge, or classification, or in a rule, regulation, or practice, after September 18, 1940, the burden of proof shall be upon the carrier to show that the proposed changed rate, fare, charge, classification, rule, regulation, or practice is just and reasonable, and the Commission shall give to the hearing and decision of such questions preference over all other questions pending before it and decide the same as speedily as possible. This paragraph shall not apply to common carriers by railroad subject to this chapter.

(8) Commission to determine lawfulness of new rates; applicability to common carrier by railroad; suspensions; accounts; hearing and basis of decision

(a) Whenever a schedule is filed with the Commission by a common carrier by railroad stating a new individual or joint rate, fare, or charge, or a new individual or joint classification, regulation, or practice affecting a rate, fare, or charge, the Commission may, upon the complaint of an interested party or upon its own initiative, order a hearing

concerning the lawfulness of such rate, fare, charge, classification, regulation, or practice. The hearing may be conducted without answer or other formal pleading, but reasonable notice shall be provided to interested parties. Such hearing shall be completed and a final decision rendered by the Commission not later than 7 months after such rate, fare, charge, classification, regulation, or practice was scheduled to become effective, unless, prior to the expiration of such 7-month period, the Commission reports in writing to the Congress that it is unable to render a decision within such period, together with a full explanation of the reason for the delay. If such a report is made to the Congress, the final decision shall be made not later than 10 months after the date of the filing of such schedule. If the final decision of the Commission is not made within the applicable time period, the rate, fare, charge, classification, regulation, or practice shall go into effect immediately at the expiration of such time period, or shall remain in effect if it has already become effective. Such rate, fare, charge, classification, regulation, or practice may be set aside thereafter by the Commission if, upon complaint of an interested party, the Commission finds it to be unlawful.

(b) Pending a hearing pursuant to subdivision (a), the schedule may be suspended, pursuant to subdivision (d), for 7 months beyond the time when it would otherwise go into effect, or for 10 months if the Commission makes a report to the Congress pursuant to subdivision (a), except under the following conditions:

(i) in the case of a rate increase, a rate may not be suspended on the ground that it exceeds a just and reasonable level if the rate is within a limit specified in subdivision (c), except that such a rate change may be suspended under any provision of section 2, 3, or 4 of this Appendix or, following

promulgation of standards and procedures under section 1(5)(d) of this Appendix, if the carrier is found to have market dominance, within the meaning of section 1(5)(c)(i) of this Appendix, over the service to which such rate increase applies; or

(ii) in the case of a rate decrease, a rate may not be suspended on the ground that it is below a just and reasonable level if the rate is within a limit specified in subdivision (c), except that such a rate change may be suspended under any provision of section 2, 3, or 4 of this Appendix, or for the purposes of investigating such rate change upon a complaint that such rate change constitutes a competitive practice which is unfair, destructive, predatory or otherwise undermines competition which is necessary in the public interest.

(c) The limitations upon the Commission's power to suspend rate changes set forth in subdivisions (b)(i) and (ii) apply only to rate changes which are not of general applicability to all or substantially all classes of traffic and only if -

(i) the rate increase or decrease is filed prior to July 1, 1980;

(ii) the common carrier by railroad notifies the Commission that it wishes to have the rate considered pursuant to this subdivision; and

(iii) the aggregate of increases or decreases in any rate filed pursuant to clause (i) or (ii) of this subdivision during any calendar year is not greater than 7 per centum of the rate in effect on January 1 of that year.

(d) The Commission may not suspend a rate under this paragraph unless it appears from specific facts shown by the verified complaint of any person that-

(i) without suspension the proposed rate change will cause substantial injury to the complainant or the party represented by such complainant; and

(ii) it is likely that such complainant will prevail on the merits.

The burden of proof shall be upon the complainant to establish the matters set forth in clauses (i) and (ii) of this subdivision. Nothing in this paragraph shall be construed as establishing a presumption that any rate increase or decrease in excess of the limits set forth in clause (iii) of subdivision (c) is unlawful or should be suspended.

(e) If a hearing is initiated under this paragraph with respect to a proposed increased rate, fare, or charge, and if the schedule is not suspended pending such hearing and the decision thereon, the Commission shall require the railroads involved to keep an account of all amounts received because of such increase from the date such rate, fare, or charge became effective until the Commission issues an order or until 7 months after such date, whichever first occurs, or, if the hearings are extended pursuant to subdivision (a), until an order issues or until 10 months elapse, whichever first occurs. The account shall specify by whom and on whose behalf the amounts are paid. In its final order, the Commission shall require the common carrier by railroad to refund to the person on whose behalf the amounts were paid that portion of such increased rate, fare, or charge found to be not justified, plus interest at a rate which is equal to the average yield (on the date such schedule is filed) of marketable securities of the

United States which have a duration of 90 days. With respect to any proposed decreased rate, fare, or charge which is suspended, if the decrease or any part thereof is ultimately found to be lawful, the common carrier by railroad may refund any part of the portion of such decreased rate, fare, or charge found justified if such carrier makes such a refund available on an equal basis to all shippers who participated in such rate, fare, or charge according to the relative amounts of traffic shipped at such rate, fare, or charge.

(f) In any hearing under this section, the burden of proof is on the common carrier by railroad to show that the proposed changed rate, fare, charge, classification, rule, regulation, or practice is just and reasonable. The Commission shall specifically consider, in any such hearing, proof that such proposed changed rate, fare, charge, classification, rule, regulation, or practice will have a significantly adverse effect (in violation of section 2 or 3 of this Appendix) on the competitive posture of shippers or consignees affected thereby. The Commission shall give such hearing and decision preference over all other matters relating to railroads pending before the Commission and shall make its decision at the earliest practicable time.

(9) Commission to investigate lawfulness of rates with respect to market dominance of common carrier by railroad; conclusiveness of findings; suspensions

Following promulgation of standards under section 1(5)(d) of this Appendix, whenever a rate of a common carrier by railroad subject to this chapter is challenged as being unreasonably high, the Commission shall, upon complaint or upon its own initiative and within 90 days after the commencement of a proceeding to investigate the lawfulness of such rate, determine whether the carrier proposing such

rate has market dominance, within the meaning of section 1(5)(c)(i) of this Appendix, over the service to which such rate applies. If the Commission finds that such a carrier does not have such market dominance, such finding shall be determinative in all additional or other proceedings under this Act concerning such rate or service, unless (a) such finding is modified or set aside by the Commission, or (b) such finding is set aside by a court of competent jurisdiction. Nothing in this paragraph shall limit the Commission's power to suspend a rate mpursuant to this section, except that if the Commission has found that a carrier does not have such market dominance over the service to which a rate applies, the Commission may not suspend any increase in such rate on the ground that such rate as increased exceeds a just or reasonable maximum for such service, unless the Commission specifically modifies or sets aside its prior determination concerning market dominance over the service to which such rate applies.

(10) Shipper's choice of route to be observed

In all cases where at the time of delivery of property to any railroad corporation being a common carrier for transportation subject to the provisions of this chapter to any point of destination, between which and the point of such delivery for shipment two or more through routes and through rates shall have been established as in this chapter provided to which through routes and through rates such carrier is a party, the person, firm, or corporation making such shipment, subject to such reasonable exceptions and regulations as the Interstate Commerce Commission shall from time to time prescribe, shall have the right to designate in writing by which of such through routes such property shall be transported to destination, and it shall thereupon be the duty of the initial carrier to route said property and issue a through bill of lading therefor as so directed, and to transport said property over its

own line or lines and deliver the same to a connecting line or lines according to such through route, and it shall be the duty of each of said connecting carriers to receive said property and transport it over the said line or lines and deliver the same to the next succeeding carrier or consignee according to the routing instructions in said bill of lading:

Provided, however, That the shipper shall in all instances have the right to determine, where competing lines of railroad constitute portions of a through line or route, over which of said competing lines so constituting a portion of said through line or route his freight shall be transported.

(11) Liability of carriers where property is delivered contrary to routing instructions

Whenever property is diverted or delivered by one carrier to another carrier contrary to routing instructions in the bill of lading, unless such diversion or delivery is in compliance with a lawful order, rule, or regulation of the Commission, such carriers shall, in a suit or action in any court of competent jurisdiction, be jointly and severally liable to the carrier thus deprived of its right to participate in the haul of the property, for the total amount of the rate or charge it would have received had it participated in the haul of the property. The carrier to which the property is thus diverted shall not be liable in such suit or action if it can show, the burden of proof being upon it, that before carrying the property it had no notice, by bill of lading, waybill or otherwise, of the routing instructions. In any judgment which may be rendered the plaintiff shall be allowed to recover against the defendant a reasonable attorney's fee to be taxed in the case.

(12) Direction of unrouted traffic by Commission

With respect to traffic not routed by the shipper, the Commission may, whenever the public interest and a fair distribution of the traffic require, direct the route which such traffic shall take after it arrives at the terminus of one carrier or at a junction point with another carrier, and is to be there delivered to another carrier.

(13) Disclosure or solicitation of information concerning shipments unlawful; exceptions

It shall be unlawful for any common carrier subject to the provisions of this chapter, or any officer, agent, or employee of such common carrier, or for any other person or corporation lawfully authorized by such common carrier to receive information therefrom, knowingly to disclose to or permit to be acquired by any person or corporation other than the shipper or consignee, without the consent of such shipper or consignee, any information concerning the nature, kind, quantity, destination, consignee, or routing of any property tendered or delivered to such common carrier for interstate transportation, which information may be used to the detriment or prejudice of such shipper or consignee, or which may improperly disclose his business transactions to a competitor; and it shall also be unlawful for any person or corporation to solicit or knowingly receive any such information which may be so used: Provided, That nothing in this chapter shall be construed to prevent the giving of such information in response to any legal process issued under the authority of any State or Federal court, or to any officer or agent of the Government of the United States, or of any State or Territory, in the exercise of his powers, or to any officer or other duly authorized person seeking such information for the prosecution of persons charged with or suspected of

crime; or information given by a common carrier to another carrier or its duly authorized agent, for the purpose of adjusting mutual traffic accounts in the ordinary course of business of such carriers.

(14) Penalty for violation of preceding provisions

Any person, corporation, or association violating any of the provisions of paragraph 13 of this section shall be deemed guilty of a misdemeanor, and for each offense, on conviction, shall pay to the United States a penalty of not more than $1,000.

15) Allowance for service or facilities furnished by shipper

If the owner of property transported under this chapter directly or indirectly renders any service connected with such transportation, or furnishes any instrumentality used therein, the charge and allowance therefor shall be published in tariffs or schedules filed in the manner provided in this chapter and shall be no more than is just and reasonable, and the Commission may, after hearing on a complaint or on its own initiative, determine what is a reasonable charge as the maximum to be paid by the carrier or carriers for the services so rendered or for the use of the instrumentality so furnished, and fix the same by appropriate order, which order shall have the same force and effect and be enforced in like manner as the orders above provided for under this section.

(16) Other powers of Commission not excluded

The foregoing enumeration of powers shall not exclude any power which the Commission would otherwise have in the making of an order under the provisions of this chapter.

(17) Standards and expeditious procedures for establishment of rates based on seasonal, regional, or peak-period demand for rail services; annual report

Within 1 year after February 5, 1976, the Commission shall establish, by rule, standards and expeditious procedures for the establishment of railroad rates based on seasonal, regional, or peak-period demand for rail services. Such standards and procedures shall be designed to (a) provide sufficient incentive to shippers to reduce peak-period shipments, through rescheduling and advance planning; (b) generate additional revenues for the railroads; and (c) improve (i) the utilization of the national supply of freight cars, (ii) the movement of goods by rail, (iii) levels of employment by railroads, and (iv) the financial stability of markets served by railroads. Following the establishment of such standards and procedures, the Commission shall prepare and submit to the Congress annual reports on the implementation of such rates, including recommendations with respect to the need, if any, for additional legislation to facilitate the establishment of such demand-sensitive rates.

(18) Expeditious procedures for separate rates for distinct rail services

In order to encourage competition, to promote increased reinvestment by railroads, and to encourage and facilitate increased nonrailroad investment in the production of rail services, a carrier by railroad subject to this chapter may, upon its own initiative or upon the request of any shipper or receiver of freight, file separate rates for distinct rail services. Within 1 year after February 5, 1976, the Commission shall establish, by rule, expeditious procedures for permitting publication of separate rates for distinct rail services in order to (a) encourage the pricing of such services in accordance

with the carrier's cash-outlays for such services and the demand therefor, and (b) enable shippers and receivers to evaluate all transportation and related charges and alternatives.

(19) Establishment of rate incentives for capital investment

Notwithstanding any other provision of law, a common carrier by railroad subject to this chapter may file with the Commission a notice of intention to file a schedule stating a new rate, fare, charge, classification, regulation, or practice whenever the implementation of the proposed schedule would require a total capital investment of $1,000,000 or more, individually or collectively, by such carrier, or by a shipper, receiver, or agent thereof, or an interested third party. The filing shall be accompanied by a sworn affidavit setting forth in detail the anticipated capital investment upon which such filing is based. Any interested person may request the Commission to investigate the schedule proposed to be filed, and upon such request the Commission shall hold a hearing with respect to such schedule. Such hearing may be conducted without answer or other formal pleading, but reasonable notice shall be provided to interested parties. Unless, prior to the 180-day period following the filing of such notice of intention, the Commission determines, after a hearing, that the proposed schedule, or any part thereof, would be unlawful, such carrier may file the schedule at any time within 180 days thereafter to become effective after 30 days' notice. Such a schedule may not, for a period of 5 years after its effective date, be suspended or set aside as unlawful under section 1, 2, 3, or 4 of this Appendix, except that the Commission may at any time order such schedule to be revised to a level equaling the variable costs of providing

the service, if the rate stated therein is found to reduce the going concern value of the carrier.

(Feb. 4, 1887, ch. 104, pt. I, Sec. 15, 24 Stat. 384; June 29, 1906, ch. 3591, Sec. 4, 34 Stat. 589; June 18, 1910, ch. 309, Sec. 12, 36 Stat. 551; Feb. 28, 1920, ch. 91, Sec. 418-421, 41 Stat. 484-488; Mar. 4, 1927, ch. 510, Sec. 2, 44 Stat. 1447; June 19, 1934, ch. 652, Sec. 602(b), 48 Stat. 1102; Aug. 9, 1935, ch. 498, Sec. 1, 49 Stat. 543; Sept. 18, 1940, ch. 722, title I, Sec. 10(a)-(d), 54 Stat. 911, 912; Feb. 5, 1976, Pub. L. 94-210, title II, Sec. 201, 202(c)-(e), 203(a), 206, title III, Sec. 302, 90 Stat. 34-37, 39, 41, 48; Oct. 19, 1976, Pub. L. 94-555, title II, Sec. 220(m), 90 Stat. 2630; Nov. 8, 1978, Pub. L. 95-607, title IV, Sec. 401, 92 Stat. 3067.)

42 USC § 7172

January 22, 2002

TITLE 42 - THE PUBLIC HEALTH AND WELFARE

CHAPTER 84 - DEPARTMENT OF ENERGY

SUBCHAPTER IV - FEDERAL ENERGY REGULATORY COMMISSION

Sec. 7172. Jurisdiction of Commission

AMENDMENTS

1994 - Subsec. (b). Pub. L. 103-272 struck out subsec. (b) which read as follows: ''There are transferred to, and vested in, the Commission all functions and authority of the Interstate Commerce Commission or any officer or component of such Commission where the regulatory function establishes rates or charges for the transportation of oil by pipeline or establishes the valuation of any such pipeline.'' See section 60502 of Title 49, Transportation.

OIL PIPELINE REGULATORY REFORM

Pub. L. 102-486, title XVIII, Oct. 24, 1992, 106 Stat. 3010, provided that:

SEC. 1801. OIL PIPELINE RATEMAKING METHODOLOGY.

(a) Establishment. - Not later than 1 year after the date of the enactment of this Act (Oct. 24, 1992), the Federal Energy Regulatory Commission shall issue a final rule which establishes a simplified and

generally applicable ratemaking methodology for oil pipelines in accordance with section 1(5) of part I of the Interstate Commerce Act (former 49 U.S.C. § 1(5)).

(b) Effective Date. - The final rule to be issued under subsection (a) may not take effect before the 365th day following the date of the issuance of the rule.

SEC. 1802. STREAMLINING OF COMMISSION PROCEDURES.

(a) Rulemaking. - Not later than 18 months after the date of the enactment of this Act (Oct. 24, 1992), the Commission shall issue a final rule to streamline procedures of the Commission relating to oil pipeline rates in order to avoid unnecessary regulatory costs and delays.

(b) Scope of Rulemaking. - Issues to be considered in the rulemaking proceeding to be conducted under subsection (a) shall include the following:

(1) Identification of information to be filed with an oil pipeline tariff and the availability to the public of any analysis of such tariff filing performed by the Commission or its staff.

(2) Qualification for standing (including definitions of economic interest) of parties who protest oil pipeline tariff filings or file complaints thereto.

(3) The level of specificity required for a protest or complaint and guidelines for Commission

action on the portion of the tariff or rate filing subject to protest or complaint.

(4) An opportunity for the oil pipeline to file a response for the record to an initial protest or complaint.

(5) Identification of specific circumstances under which Commission staff may initiate a protest.

(c) Additional Procedural Changes. - In conducting the rulemaking proceeding to carry out subsection (a), the Commission shall identify and transmit to Congress any other procedural changes relating to oil pipeline rates which the determines are necessary to avoid unnecessary regulatory costs and delays and for which additional legislative authority may be necessary.

(d) Withdrawal of Tariffs and Complaints. -

(1) Withdrawal of tariffs. - If an oil pipeline tariff which is filed under part I of the Interstate Commerce Act (former 49 U.S.C. § 1 *et seq.*) and which is subject to investigation is withdrawn -

(A) any proceeding with respect to such tariff shall be terminated;

(B) the previous tariff rate shall be reinstated; and

(C) any amounts collected under the withdrawn tariff rate which are in

excess of the previous tariff rate shall be refunded.

(2) Withdrawal of complaints. - If a complaint which is filed under section 13 of the Interstate Commerce Act (former 49 U.S.C. § 13) with respect to an oil pipeline tariff is withdrawn, any proceeding with respect to such complaint shall be terminated.

(e) Alternative Dispute Resolution. - To the maximum extent practicable, the Commission shall establish appropriate alternative dispute resolution procedures, including required negotiations and voluntary arbitration, early in an oil pipeline rate proceeding as a method preferable to adjudication in resolving disputes relating to the rate. Any proposed rates derived from implementation of such procedures shall be considered by the Commission on an expedited basis for approval.

SEC. 1803. PROTECTION OF CERTAIN EXISTING RATES.

(a) Rates Deemed Just and Reasonable. - Except as provided in subsection (b) -

(1) any rate in effect for the 365-day period ending on the date of the enactment of this Act (Oct. 24, 1992) shall be deemed to be just and reasonable (within the meaning of section 1(5) of the Interstate Commerce Act (former 49 U.S.C. § 1(5))); and

(2) any rate in effect on the 365th day preceding the date of such enactment shall be deemed to be just and reasonable (within the meaning of such section 1(5)) regardless of whether or not, with respect to such rate, a new rate has been filed with the Commission during such 365-day period; if the rate in effect, as described in paragraph (1) or (2), has not been subject to protest, investigation, or complaint during such 365-day period.

(b) Changed Circumstances. - No person may file a complaint under section 13 of the Interstate Commerce Act (former 49 U.S.C. § 13) against a rate deemed to be just and reasonable subsection (a) unless -

(1) evidence is presented to the Commission which establishes that a substantial change has occurred after the date of the enactment of this Act (Oct. 24, 1992) -

(A) in the economic circumstances of the oil pipeline which were a basis for the rate; or

(B) in the nature of the services provided which were a basis for the rate; or

2) the person filing the complaint was under a contractual prohibition against the filing of a complaint which was in effect on the date of enactment of this Act and had been in effect prior to January 1, 1991, provided that a complaint by a party bound by such

prohibition is brought within 30 days after the expiration of such prohibition.

If the Commission determines pursuant to a proceeding instituted as a result of a complaint under section 13 of the Interstate Commerce Act that the rate is not just and reasonable, the rate shall not be deemed to be just and reasonable. Any tariff reduction or refunds that may result as an outcome of such a complaint shall be prospective from the date of the filing of the complaint.

(c) Limitation Regarding Unduly Discriminatory or Preferential Tariffs. - Nothing in this section shall prohibit any aggrieved person from filing a complaint under section 13 or section 15(l) of the Interstate Commerce Act (former 49 U.S.C. § 13, 15(1)) challenging any tariff provision as unduly discriminatory or unduly preferential.

SEC. 1804. DEFINITIONS.

For the purposes of this title, the following definitions apply:

(1) Commission. - The term 'Commission' means the Federal Energy Regulatory Commission and, unless the context requires otherwise, includes the Oil Pipeline Board and any other office or component of the Commission to which the functions and authority vested in the Commission under section 402(b) of the Department of Energy Organization Act (42 U.S.C. § 7172(b)) are delegated.

(2) Oil pipeline. -

(A) In general. - Except as provided in subparagraph (B), the term 'oil pipeline' means any common carrier (within the meaning of the Interstate Commerce Act (former 49 U.S.C. § 1 *et seq.*)) which transports oil by pipeline subject to the functions and authority vested in the Commission under section 402(b) of the Department of Energy Organization Act (42 U.S.C. § 7172(b)).

(B) Exception. - The term 'oil pipeline' does not include the Trans-Alaska Pipeline authorized by the Trans-Alaska Pipeline Authorization Act (43 U.S.C. § 1651 *et seq.*) or any pipeline delivering oil directly or indirectly to the Trans-Alaska Pipeline.

(3) Oil. - The term 'oil' has the same meaning as is given such term for purposes of the transfer of functions from the Interstate Commerce Commission to the Federal Energy Regulatory Commission under section 402(b) of the Department of Energy Organization Act (42 U.S.C. § 7172(b)).

(4) Rate. - The term 'rate' means all charges that an oil pipeline requires shippers to pay for transportation services.

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 2077, 2160, 6303, 7151, 7173, 7174, 7191, 7920, 8433 of this title.

APPENDIX I

SUPREME COURT OF THE UNITED STATES

[Filed January 3, 1949]

335 U.S. 573 (1949)

AYRSHIRE COLLIERIES CORPORATION et al.

v.

UNITED STATES et al.

Mr. Justice DOUGLAS delivered the opinion of the Court.

This is an appeal, 38 Stat. 219, 220, 28 U.S.C. §§ 45 and 47a, 43 Stat. 938, 28 U.S.C. § 345(4), 28 U.S.C.A. §§ 45, 47a, 345(4), from a decree of a three-judge District Court, which dismissed without merit two complaints seeking to set aside a rate order of the Interstate Commerce Commission.[1]

[1] A prior decree sustaining this order of the Commission was reversed by the Court because one member of the three-judge District Court had not participated in the decision. *Ayrshire Collieries Corp. v. United States*, 331 U.S. 132, 67 S.Ct. 1168, 91 L.Ed. 1391.

Bituminous coal is produced in great quantities in Indiana, Illinois and western Kentucky. In each State there are producing areas that have long been grouped for rate-making purposes. These groups or districts are the Brazil-Clinton, the Linton-Sullivan, the Princeton-Ayrshire, and the Boonville in Indiana; the Northern Illinois, the Fulton-Peoria, the Springfield, the Belleville, and the Southern in Illinois; and the Western in Kentucky. Group rates have been established by the carriers so that all mines within each producing area are accorded the same rates to the same consuming destinations.[2] The result is that comparative distances of the mines in one producing area from a particular consuming destination are commonly disregarded in fixing the group rate. But the Commission has long concluded that such a system of rate making for coal and other natural resources encourages competitive production and a more even development of an area.[3]

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[2] Another characteristic of coal rate structures has been the rate differentials. For example, Brazil is the base group in Indiana on coal traffic to the Illinois and Wisconsin destinations involved in this litigation. Hence the rates, expressed in cents per ton, from the other Indiana groups are stated in terms of differences from the Brazil group rate.

[3] See *Hitchman Coal & Coke Co. v. Baltimore & O.R. Co.*, 16 I.C.C. 512, 520; *Waukesha Lime & Stone Co. v. Chicago, M. & St. P.R. Co.*, 26 I.C.C. 515, 518; *Wisconsin & Arkansas Lbr. Co. v. St. Louis, I.M. & S.R. Co.*, 33 I.C.C. 33, 37, 38; *Public Utilities Commission v. Oregon Short Line R. Co.*, 33 I.C.C. 103, 106; *Southwestern Interstate Coal v. Arkansas W.R. Co.*, 89 I.C.C. 73, 84, 85. And see *New York Harbor Case*, 47 I.C.C. 643, 712; *Illinois Commerce Commission v. United States*, 292 U.S. 474, 486, 54 S.Ct. 783, 788, 78 L.Ed. 1371.

The present litigation involves group rates for carload lots from the foregoing groups in Indiana, Illinois, and Kentucky to Rockford, Freeport, Dixon and other points in northern Illinois and to Beloit, Wisconsin.

The order under attack in this case resulted from two proceedings before the Commission which were heard and considered together on the same record. One was an investigation in which carriers proposed certain increases in rates for carload lots of bituminous coal from some of the Indiana groups to Beloit, Wisconsin, and from all of the Indiana groups to designated Illinois destinations. Like increases in the Illinois intrastate rates to the same Illinois destinations were also sought. These proposed increases have been suspended until disposition of the proceeding. The other proceeding was an investigation instituted by the Commission, on complaint, into the intrastate carload rates from the Illinois groups to the same Illinois destinations to determine whether they were discriminatory, preferential, and prejudicial against interstate commerce and in favor of intrastate commerce.

These proceedings are only a recent chapter in the problem of adjustment of the coal rates for this region.

The Illinois Commerce Commission ordered a reduction of the intrastate rates in 1930. This resulted in a reduction of certain interstate rates from Indiana and western Kentucky to Rockford and other northern Illinois points. The Interstate Commerce Commission refused to require an increase in intrastate rates to the important Illinois destinations involved here unless the rates from the Indiana groups to the same

destinations were increased.[4] Subsequently the Commission found that the rates from the Illinois, Indiana and western Kentucky groups to Beloit, Wisconsin, were in the main not unreasonable but that they were unduly prejudicial to Beloit and unduly preferential to Rockford, if they exceeded the rates from the same origins to Rockford by more than 25 cents. The Commission also found on further hearing that the rates from certain of the Illinois groups to Beloit, Wisconsin, were not unreasonable but that they were unduly prejudicial to Beloit and unduly preferential to Rockford to the extent that they exceeded the Rockford rates by more than 15 cents. The Commission allowed the carriers to increase the rates to Rockford or to reduce the rates to Beloit, or both, in order to relate the rates to Beloit 15 cents over Rockford. But the intrastate rates to Rockford had been prescribed as a maximum by the Illinois Commission and therefore could not be increased. Also to increase the interstate rates without similar increases from the Illinois groups would be disruptive of the rate structure built on the group basis. Accordingly the rates to Beloit were reduced.[5]

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[4] See Intrastate Rates on Bituminous Coal, 182 I.C.C. 537, 549, 550.

[5] The history of this rate problem is briefly summarized by the Commission in its report on the present case. 263 I.C.C. 179. For earlier aspects of it see Intrastate Rates on Bituminous Coal in Illinois, 182 I.C.C. 537; *Fairbanks-Morse & Co. v. Alton & S.R.*, 195 I.C.C. 365, 251 I.C.C. 181; *Illinois Coal Traffic Bureau v. Ahnapee & W.R. Co.*, 204 I.C.C. 225; Coal to Illinois and Wisconsin, 232 I.C.C. 151. And see Coal from Indiana to Illinois, 197 I.C.C. 245, 200 I.C.C. 609, the order in which, as we discuss hereafter in the opinion, was held invalid by *United States v. Chicago, M., St. P. & P.R. Co.*, 294 U.S. 499, 55 S.Ct. 462, 79 L.Ed. 1023.

The carriers subsequently proposed increases in the rates from the Indiana groups and the Illinois groups to Rockford and other Illinois points and, with certain exceptions, from the Indiana groups to Beloit, Wisconsin. These increases conformed to the 15-cent relation between Rockford and Beloit but placed the rates (both interstate and intrastate) more nearly at the general level of interstate rates in that territory.

One other fact must be mentioned if the present posture of this rate problem is to be understood. After the Illinois intrastate rates were reduced in 1930 and after the carriers' unsuccessful effort to have the earlier ones re-established, the Milwaukee road proposed to reduce its single-line rates from mines in the Brazil and Linton groups which it serves to Rockford, Freeport and other intermediate Illinois points by the amount of the Illinois intrastate reduction. The Commission ordered the proposed rate to be cancelled. The Court affirmed a decree of a District Court which permanently enjoined the order of the Commission. *United States v. Chicago, M., St. P. & P.R. Co.*, 294 U.S. 499, 55 S.Ct. 462, 79 L.Ed. 1023.

Since that time the rates of the Milwaukee from origins on its line in the Brazil and Linton groups to Rockford and other intermediate points in Illinois have been lower than the contemporaneous rates of carriers serving other origins in these respective groups to the same destinations, with the exception of the Illinois Central which in 1936 published rates from the Linton group to Rockford and other intermediate Illinois points on its lines on the same basis as the Milwaukee's single-line rates.

The Milwaukee and the Illinois Central serve only a part of the mines in the Brazil and Linton groups. But they carry coal from other mines in those groups even though their lines

do not reach them, since they are either connecting carriers of lines that do or destination carriers. They are therefore parties to many joint rates. But the joint rates do not reflect reductions which the Milwaukee and Illinois Central made in their single-line rates. And the rate increases proposed, and suspended by the Commission on the present proceedings, continued that previous relationship. Moreover the proposed dual basis of rates to Rockford and other Illinois destinations reached by the Milwaukee was proposed to be extended to Beloit, which previously had enjoyed the same rates from all the mines in the Brazil and Linton groups.

As we have noted, the new proposed rates respected the 15-cent differential of Beloit over Rockford. The result was a substantial increase in the joint-line rates from the Brazil and Linton groups to Beloit as well as to Rockford. But Milwaukee's single-line rates were increased 15 cents to Rockford and none to Beloit. The result would be to accord to mines in the Brazil and Linton groups that were on the Milwaukee lines rates lower to Beloit by 17 and 12 cents, respectively, than accorded the other mines in the two groups. Furthermore the new proposed rates would establish a dual basis of rates to Beloit from the Princeton group as well.

The Commission disapproved the dual basis of rates. It considered what would be the fair and reasonable rate relations as between the respective origins in the several groups and as between the groups themselves. It found that present and proposed rates of the Milwaukee and Illinois Central from Indiana to the northern Illinois destinations would result in unjust discrimination as between shippers and receivers of coal and undue preference and prejudice as between the origins in the Brazil and Linton groups and as between the respective Indiana groups. It made the same findings as respects the Milwaukee's proposed rates from the

Brazil, Linton and Princeton groups to Beloit; and in that connection it also found that those rates would result in undue preference and privilege as between the Indiana groups on the one hand and the Illinois groups on the other. The Commission went on to specify rates which it approved. It ruled that the proposed rates would be unreasonable to the extent that they were above the approved rates.[6] 263 I.C.C. 179.

We agree with the District Court that the complaints must be dismissed.

First. It is contended that the Commission in this proceeding had authority to determine the lawfulness only of the proposed rates not of the present rates.

This proceeding is an investigation and suspension proceeding under s 15(7) of the Interstate Commerce Act, 44 Stat. 1447, 49 U.S.C. § 15(7), 49 U.S.C.A. § 15(7). That section, which gives the Commission broad authority upon complaint or its own initiative to investigate and determine the lawfulness of any new rate,[7] provides that 'after full hearing,

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[6] The order entered by the Commission in the proceeding to determine whether the intrastate rates were unjustly discriminatory against interstate commerce is not under attack here. It required the carriers to desist from practices which the Commission found to be discriminatory and to establish and maintain for the intrastate transportation of coal rates no lower than the approved rates.

[7] 'Whenever there shall be filed with the commission any schedule stating a new individual or joint rate, fare, or charge, or any new individual or joint classification, or any new individual or joint regulation or practice affecting any rate, fare, or charge, the commission shall have, and it is hereby given, authority, either

whether completed before or after the rate * * * goes into effect, the commission may make such order with reference thereto as would be proper in a proceeding initiated after it had become effective.'

The power of the Commission to deal with the situation as if the proposed new rates had become effective is necessarily a comprehensive one. It seems too plain for argument that such broad authority is ample for the modification of either proposed or existing rates or both. The power granted the Commission under § 15(1) to deal with rate schedules already effective supports that view.[8] For once the Commission finds

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upon complaint or upon its own initiative without complaint, at once, and if it so orders without answer or other formal pleading by the interested carrier or carriers, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, fare, charge, classification, regulation, or practice; and pending such hearing and the decision thereon the commission, upon filing with such schedule and delivering to the carrier or carriers affected thereby a statement in writing of its reasons for such suspension, may from time to time suspend the operation of such schedule and defer the use of such rate, fare, charge, classification, regulation, or practice, but not for a longer period than seven months beyond the time when it would otherwise go into effect; and after full hearing, whether completed before or after the rate, fare, charge, classification, regulation, or practice goes into effect, the commission may make such order with reference thereto as would be proper in a proceeding initiated after it had become effective.'

[8] 'That whenever, after full hearing, upon a complaint made as provided in section 13 of this part, or after full hearing under an order for investigation and hearing made by the commission on its own initiative, either in extension of any pending complaint or without any complaint whatever, the commission shall be of opinion that any individual or joint rate, fare, or charge whatsoever

the rate to be unjust or unreasonable or unjustly discriminatory or unduly preferential or prejudicial or otherwise unlawful, the Commission is granted the power under § 15(1) to determine and prescribe the just and reasonable rate. The Commission is not bound either to approve or disapprove in toto the new rates that are proposed. It can modify the proposal in any respect and require that the proposed rates as modified or wholly different rates be substituted for the present ones. That has been the view of the

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demanded, charged, or collected by any common carrier or carriers subject to this part for the transportation of persons or property, as defined in the first section of this part, or that any individual or joint classification, regulation, or practice whatsoever of such carrier or carriers subject to the provisions of this part, is or will be unjust or unreasonable or unjustly discriminatory or unduly preferential or prejudicial, or otherwise in violation of any of the provisions of this part, the commission is hereby authorized and empowered to determine and prescribe what will be the just and reasonable individual or joint rate, fare, or charge, or rates, fares, or charges, to be thereafter observed in such case, or the maximum or minimum, or maximum and minimum, to be charged, and what individual or joint classification, regulation, or practice is or will be just, fair, and reasonable, to be thereafter followed, and to make an order that the carrier or carriers shall cease and desist from such violation to the extent to which the commission finds that the same does or will exist, and shall not thereafter publish, demand, or collect any rate, fare, or charge for such transportation other than the rate, fare, or charge so prescribed, or in excess of the maximum or less than the minimum so prescribed, as the case may be, and shall adopt the classification and shall conform to and observe the regulation or practice so prescribed.'

Commission since the beginning;[9] and we think it is the correct one.

The same result obtains as respects the Milwaukee's single-line rates from origins on its lines in the Brazil and Linton groups to Beloit, Wisconsin. The Milwaukee had not proposed any change in those rates. But those rates had been republished in the proposed schedules. They were among the rates suspended by the Commission. And the Commission's order of investigation cited the Milwaukee tariff that contains those rates. Hence the Commission sought to bring them into the investigation and gave Milwaukee all the notice to which it was entitled. That the Commission had authority to include them seems clear to us. Even though we assume they are not 'new' rates within the meaning of § 15(7), they are rates 'demanded, charged, or collected' within the meaning of § 15(1).

Second. Section 2 of the Act, 49 U.S.C.A. § 2, makes it unlawful for a carrier to receive from one person a greater or less compensation for transporting property than it receives from another for doing a 'like and contemporaneous service in the transportation of a like kind of traffic under substantially similar circumstances and conditions.'[10] It is

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[9] See *Advances in Rates--Western Case*, 20 I.C.C. 307, 314; *Lignite Coal from N. Dakota*, 126 I.C.C. 243, 244.

[10] 'That if any common carrier subject to the provisions of this part shall, directly or indirectly, by any special rate, rebate, drawback, or other device, charge, demand, collect, or receive from any person or persons a greater or less compensation for any service rendered or to be rendered, in the transportation of passengers or property, subject to the provisions of this part, than it charges, demands, collects, or receives from any other person or persons for

pointed out that the purpose of this section is to enforce equality between shippers of like commodities over the same line or haul for the same distance and between the same points.[11] This requirement, it is argued, has not been met in the present case since there is no finding that any of the coal from any origin point to any destination was being charged a higher rate than other coal from the same origin point to the same destination moving over the same line under substantially similar circumstances and conditions. The contention would be well taken if the Commission was not warranted in treating all places within a particular group or district as one origin point. Whether or not the Commission was warranted in doing so, depends primarily on the legality of its action in gathering together various origin points into one rate group for rate-making purposes.

As we have noted[12] that has been an historic method of building coal rate structures. The Commission followed that method in this case because in its opinion such a rate structure was necessary to afford consumers, coal operators, and carriers a fair opportunity to compete in the purchase, sale

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doing for him or them a like and contemporaneous service in the transportation of a like kind of traffic under substantially similar circumstances and conditions, such common carrier shall be deemed guilty of unjust discrimination, which is prohibited and declared to be unlawful.'

[11] See *Interstate Commerce Commission v. Baltimore & O.R. Co.*, 145 U.S. 263, 280, 12 S.Ct. 844, 849, 36 L.Ed. 699; *Interstate Commerce Commission v. Alabama Midland R. Co.*, 168 U.S. 144, 166, 18 S.Ct. 45, 48, 49, 42 L.Ed. 414; Barringer & Co. v. United States, 319 U.S. 1, 6, 729, 63 S.Ct. 967, 970, 87 L.Ed. 1171.

[12] See note 3, *supra*.

and transportation of coal from the mines in the various groups of districts to the destinations in question. The Commission's power so to act is not challenged here. Yet once the legality of the grouping of mines for rate purposes is accepted, the result is clear. For the protection of one shipper against unjust discrimination in favor of another within the same group is as clearly within the purpose of § 2 as the protection of one factory against unjust discrimination in favor of another in the same community.

The Milwaukee and Illinois Central were granting more favorable rates to some origins than to others in the same groups or districts. Their single-line rates from mines on their own lines were much lower than joint-line rates from other mines in the same group to the same destinations. The latter are rates published by other carriers and in which Milwaukee and Illinois Central join. Milwaukee and Illinois Central therefore are parties to an arrangement which results in some mines getting lower rates than other mines in the same group on shipments to the same destinations.

The question remains whether that preferential treatment of shippers at some origins was an unjust discrimination within the meaning of § 2.

The single line rates of Milwaukee and Illinois Central from the Linton group to northern Illinois destinations were 12 cents lower than the joint-line rates to the same points from other mines in the Linton group. The like differential as respects the Brazil group was 17 cents. The proposed schedules continued that dual basis of rates and extended it to Beloit, Wisconsin. The Commission made what seems to us a permissible inference, that rates favorable to the mines on the single-rate routes played an important part in getting the great bulk of the tonnage from the roads having the higher

joint rates. Thus Milwaukee served only 4 of the 30 mines in the Brazil group and only 9 of the 31 in the Linton group. But in what the Commission called a representative period, Milwaukee handled under its single-line rates over 95 per cent of the tonnage moving from Brazil to Rockford and over 78 per cent of that from Linton to Rockford. The Commission concluded that the maintenance of the dual basis of rates therefore had an important bearing on the future opportunities of shippers within the respective groups to market their coal in the destination territory. It found that there was severe competition in marketing coal in this territory and that a differentially related and finely balanced rate structure on the coal was necessary in order to meet the needs of the consuming public, the mine operators, and the carriers. For, in general, all of the mines in these groups produce coal of the same quality and grade. A difference of a few cents per ton in the transportation charge is normally sufficient to divert a coal contract from one mine to another. Yet the Commission found that the transportation conditions over the single-line routes do not differ materially from those over the joint-line routes to the same destinations from other mines in the same group; that there is no important difference in the average distances over those respective routes.

The latter findings especially the one respecting the similarity of transportation conditions, are severely challenged as being without any support in the evidence. These findings, when judged by the classic examples of unjust discrimination between shippers, leave much to be desired. But we think they are adequate in this case. They reflect an intimate acquaintance by the Commission with the grouping of mines for rate-making purposes. *See* 263 I.C.C., p. 196. The groups are themselves designed to equalize competitive opportunities. The location of the mines, their distances from destination territory, the transportation conditions over the

lines that serve the various origins within a group--these are all factors which bear on the determination of what mines shall be pulled together into one group. The Commission can draw from its long experience with these groupings to determine whether any variables in transportation conditions warrant a difference of rates as between mines within one group to a common destination. Or to state it otherwise, the attack here could not succeed unless it were on the respective groupings themselves. The appellants, of course, claim the right to initiate rates within the zone of reasonableness. *See United States v. Chicago, M., St. P. & P.R. Co., supra.* But the Commission holds that when that power is used to establish a dual basis of rates for this coal mining region, it defeats the system of grouping by unjustly discriminating against some shippers and in favor of others in the same group. The Commission's conclusion that only by the establishment and maintenance of a single-rate basis can that unjust discrimination be avoided is an informed judgment based on a complex of many factors. It cannot be successfully challenged on this record unless the whole system of rate-making on a group basis is undermined. But no such major project is undertaken.

What we have just said also disposes of the attack which is made on the findings and conclusion of the Commission that the present and proposed system of dual rates creates an undue preference and prejudice as between the origins in the Brazil and Linton groups in violation of § 3(1) of the Act, 49 U.S.C.A. § 3(1).[13]

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[13] 'It shall be unlawful for any common carrier subject to the provisions of this part to make, give, or cause any undue or unreasonable preference or advantage to any particular person, company, firm, corporation, association, locality, port, port district, gateway, transit point, region, district, territory, or any

Third. The Commission found that the differentials maintained by the Milwaukee and Illinois Central as between certain of the Indiana groups constituted an undue preference and prejudice in violation of § 3(1) of the Act.[14]

The Commission found that the differential, Linton over Brazil, should be 10 cents. This is the standard differential, in effect generally to the northwest. It found that the standard differential, Princeton over Linton, was 7 cents. Milwaukee's differential in the former would be 22 cents; and the differential of the Milwaukee and Illinois Central in the latter would be 19 cents. The main attack of appellants on this phase of the case is the Commission's conclusion that these differentials are greater than those warranted by the respective differences in distances. Facts are adduced to show that they fairly reflect differences in distances.

But the Commission made plain that in considering the whole problem of rate relations presented by this case it did

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particular description of traffic, in any respect whatsoever; or to subject any particular person, company, firm, corporation, association, locality, port, port district, gateway, transit point, region, district, territory, or any particular description of traffic to any undue or unreasonable prejudice or disadvantage in any respect whatsoever * * *.'

[14] 'The Milwaukee and the Illinois Central join in rates from the Princeton and Boonville groups to these northern Illinois destinations which reflect differences between those groups on the one hand, and the Brazil and Linton points served by those two respondents on the other, that are substantially greater than the so-called standard differentials and greater than are warranted by the respective differences in distance.'

not rely strictly upon distance. Distance was a factor but it was not controlling. The Commission deemed its task to be the creation of a rate structure that would afford a fair opportunity to compete in the purchase, sale and transportation of the coal from the various mines to the destinations in question.

The propriety of that action of the Commission is determinative of another phase of the case as well. It goes to the heart of appellants' objections to the differentials prescribed by the Commission as fair and reasonable as between the Indiana groups and the Illinois groups.

The Commission approved rates from the Indiana groups to twelve Illinois destinations which averaged $1.95 from Brazil, $2.05 from Linton, and $2.12 from Princeton-Boonville. These rates, the Commission found, compared favorably with the proposed rates to the same destinations from the Illinois groups,[15] apart from exceptions not now material.

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[15] The Commission in determining maximum reasonable rates from the Fulton-Peoria group to Iowa destinations developed the so-called Midland scale. *See Midland Electric Coal Corp. v. Chicago, N. & W.R. Co.*, 232 I.C.C. 5. It used the so-called Indiana-Illinois scale for the same purpose in connection with certain Indiana groups to eastern-central Illinois designations. *See Coal Trade Assn. v. Baltimore & O.R. Co.*, 190 I.C.C. 743. In the present case the Commission made certain adjustments in those scales, *see* 263 I.C.C. at 186, and used them in the comparison of the approved Indiana rates with the approved Illinois rates. Those combined rates for Indiana to twelve northern Illinois destinations average 86.1 per cent of the Indiana-Illinois scale and 70.7 per cent of the Midland scale. While the combined rates for the Illinois groups to those destinations averaged 85.4 per cent and 70.3 per cent of those scales.

The Commission approved rates of $2.22 from Brazil to Beloit, Wisconsin, $2.32 from Linton, and $2.39 from

The chief problem of the Commission in this case was to provide a rate structure which would afford fair and reasonable relations of rates to northern Illinois destinations, both as between the respective origin groups and as between Indiana groups and Illinois groups. There had been historically no fixed relation either between the former or the latter. And the appearance of a dual basis of rates greatly distorted the picture. The Commission did in this case what the Court pointed out in *United States v. Chicago, M., St. P. & P.R. Co.*, *supra*, 294 U.S. at page 510, 55 S.Ct. at page 467, 79 L.Ed. 1023, it had not done there, *viz.*, it adjudged the fairness of the relation subsisting between Illinois and Indiana rates.

Appellants however contend that what the Commission did was wholly arbitrary. They point to instances where the rate from an Indiana group is more than the rate from an Illinois group even though the haul is shorter. They say that what the Commission did was to adjust the rates not to compensate for the transportation service rendered but to favor Illinois groups over Indiana groups. They give illustration after illustration of the inconsistencies between the specific rates, assuming, as the Commission found, that the transportation conditions which were involved were the same. From that argument appellants seek to make two points--(1) that the rates approved by the Commission do not reflect group differentials designed to eliminate discrimination and preference and (2) that, even

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Princeton-Boonville, rates which the Commission found compared favorably with the present rates from the Illinois groups to Beloit. Taken as a whole, the approved rates from Indiana to Beloit averaged 94.3 per cent of the Indiana-Illinois scale and 77.1 per cent of the Midland scale, while the combined present rates from the Illinois groups to Beloit average 92.9 per cent and 76.6 per cent of the respective scales.

though they do, individual rates are established that are wholly arbitrary in violation of the principle that each destination is entitled to a reasonable rate.

We cannot deny the Commission authority to use averages as a measure of the relationship between the rates of the Indiana groups on the one hand and the Illinois groups on the other. The averages would be some indication of the closeness of the alignment. The important comparison here is in the regional or group differentials. These differentials in the present case were not designed so as to be faithful to the factor of distance. The Commission followed the common practice in giving diminishing weight to distance and increasing weight to competition as the length of the haul increased. The Commission said, 263 I.C.C. at 204,

> 'In approving the foregoing rate relations, we have kept in mind the importance to consumers, coal operators, and railroads of relating these differentially-related coal rates, not strictly upon distance, but so as to afford all concerned a fair opportunity to compete in the purchase, sale, and transportation of coal from Illinois and Indiana mines to these destinations. The rates between the various origin groups in these fields have never been made with primary regard for distance, and to so make them now would have the effect eventually of eliminating practically all competition between most of them, a result which would be highly undesirable to the consumer, whose interests we may not disregard.'[16]

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[16] The Commission made this additional observation concerning the weight it gave to distance, 263 I.C.C. at 204,

> 'And in according such weight to distance as seemed to us

There is no doubt, therefore, that the Commission believed that the competitive factor was an important one in considering this problem of rate relationships. The result may, as appellants contend, favor some Illinois mines over Indiana as respects certain markets. That would seem to follow, for example, from the elimination of the low single-line rate that the Commission found to be disruptive of rate relations between these groups. But it does not indicate

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to be fair and reasonable, we have also kept in mind that the average distances of record, and as used in this report, especially from Illinois mines, frequently reflect seeming inconsistencies from the same group to destinations in close proximity to each other. For example, Amboy is located south of and about 12 miles over the Illinois Central and across country less distant from the Illinois groups than Dixon, but the average shortest-tariff route distance from the Springfield group is 9 miles greater and from the southern Illinois group 1 mile greater to the former than to the latter. By use of the short tariff routes the distance to Amboy is 9 miles greater from Springfield and 7 miles greater from southern Illinois than to Dixon. These variations in distance are due to the different routes used and also to the fact that frequently the group rate applies from a larger number of origins to one destination than to another. Thus, to Dixon the Springfield rate is published from 61 origins on 15 originating railroads, but to Amboy the rate applies from only 23 origins on 8 railroads. So also, the southern Illinois rate applies from 75 origins on 7 roads to Dixon and 65 origins on 5 roads to Amboy. The variations in distance thus brought about are much greater from Illinois groups than from Indiana groups. It is plain, therefore, that comparisons based on distance, especially as between Indiana and Illinois groups to particular destinations, can not be accepted as controlling, but must be evaluated with the above facts in mind.'

that the rates approved by the Commission were unlawful. That might be established by showing, for example, that the Commission gave weight only to the competitive factor. Yet all that appellants attempt here is to show that discrepancies in rates are not warranted by any difference in transportation conditions or in distance. That is not enough provided the Commission was justified in considering the element of competition.

We think it was. Rate structures are not designed merely to favor the revenues of producers and carriers. The Commission has the consumer interest to safeguard as well.[17] And when it undertakes to rationalize the interests of the three, great complexities are often encountered. The economics of the bituminous coal industry have baffled even experts. We would depart from our competence and our limited function in this field if we undertook to accommodate the factors of transportation conditions, distance and competition differently than the Commission has done in this case. That is a task peculiarly for it. In fashioning what the Commission called a differentially related and finely balanced rate structure for this coal, there is no place for dogma or rigid formulae. The problem calls for an expert, informed judgment on a multitude of facts. The result is that the administrative rate-maker is left with broad discretion as long as no statutory requirement is overlooked. Yet that is, of

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[17] The consumer interest traditionally has been prominent in the Commission's consideration of the type of problem presented here. *See Andy's Ridge Coal Co. v. Southern R. Co.*, 18 I.C.C. 405, 410; *Waukesha Lime and Stone Co. v. C.M. & St. P.R. Co.*, supra, at 518, 519; *Wisconsin & Arkansas Lumber Co. v. St. L., I.M. & S.R. Co.*, *supra*, at 37, 38; *Southwestern Coal Operators' Assn. v. A.W.R. Co.*, *supra*, at 85; *Coal to Illinois*, 7 Wisconsin, *supra*, at 167, 169.

course, precisely the nature of the administrative process in this field. *See Board of Trade v. United States*, 314 U.S. 534, 548, 62 S.Ct. 366, 372, 373, 86 L.Ed. 432; *State of New York v. United States*, 331 U.S. 284, 347--349, 67 S.Ct. 1207, 1240, 1241, 91 L.Ed. 1492.

Fourth. Appellants argue that the Commission acted beyond its authority because it did not afford the carriers alternative methods of removing the discrimination which was found to exist. *See Texas & Pacific R. Co. v. United States*, 289 U.S. 627, 53 S.Ct. 768, 77 L.Ed. 1410. And Milwaukee argues that the Commission was without power to direct it to cease from granting the undue preference found to exist between its single-line rate and the higher joint-line rates, since it had no control over the latter.

This is not a case like *Texas & Pacific R. Co. v. United States*, *supra*, where the Commission issues a so-called alternative order directing the carriers to remove an unjust discrimination or undue preference which has been found. That kind of order leaves a choice to the carriers whether to eliminate the unlawful practice by raising one rate, lowering the other, or altering both. But as we recently held in *State of New York v. United States*, *supra*, 331 U.S. at page 342, 67 S.Ct. at pages 1237, 1238, 91 L.Ed. 1492, that rule is not applicable where the Commission itself undertakes to correct the unlawful practice by prescribing the just and reasonable rate. The Commission has taken that action here. As we noted above, the present proceeding was one under § 15(1) and § 15(7). Section 15(1) gives the Commission power to determine and prescribe the just and reasonable rate once it finds, inter alia, that any rate charged is unjustly discriminating or unduly preferential or prejudicial. The Commission in the present case has exercised that power. It has prescribed approved rates. They are rates which in the

Commission's judgment will eliminate the unjust discrimination and undue preference found to exist in this rate structure. Hence the question whether Milwaukee effectively controlled the higher joint-line rates is irrelevant here. *State of New York v. United States*, *supra*.

Finally it is suggested that the order is invalid because the Commission did not find that the preferential rates were noncompensatory. But once a forbidden discrimination or preference in rates is found, the Commission may remove it even though the rates are within the zone of reasonableness. *State of New York v. United States*, *supra*, 331 U.S. at page 344, 67 S.Ct. at page 1238, 91 L.Ed. 1492.

Affirmed.